Supreme Court, U. S.
FILED
JUL 28 1976
MICHAEL RODAK, JR., CLERK

APPENDIX

In the Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-1285

UNITED STATES OF AMERICA, PETITIONER

v.

PENN SECURITY LIFE INSURANCE COMPANY

On Writ of Certiorari to the United States Court of Claims

PETITION FOR A WRIT OF CERTIORARI FILED MARCH 9, 1976
CERTIORARI GRANTED MAY 24, 1976

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214-447—76

In the Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-1285

UNITED STATES OF AMERICA, PETITIONER

v.

PENN SECURITY LIFE INSURANCE COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

DOCKET ENTRIES

General Docket, Case No. 109-68

ITT HAMILTON LIFE INSURANCE COMPANY, A CORPORATION

Jan 15 1973	Motion to change name to "Penn Security Life Insurance Company" filed.
Apr 4 1968	Filing fee of $10 paid by plaintiff.
Apr 23 1968	Court filed order referring case to Commissioner Vacated.
Jun 2 1968	Defendant's motion for extension of time (to July 3, 1968) to file answer filed. Copies (2) to atty. ALLOWED JUN 19 1968.
Jul 3 1968	Defendant's answer to the petition filed. Copies (2) to atty.
Jul 10 1968	Defendant's answer to petition received. Copies (10) to atty.
May 8 1969	Defendant's motion for leave to file amended answer filed. Copies (2) to atty. ALLOWED JUL 8 1969.
May 22 1969	Plaintiff's motion for extention of time (to June 2, 1969) to respond to motion for leave to file amended answer filed. Copies (2) to deft. ALLOWED MAY 22 1969.

Jun 4 1969	Plaintiff's motion for extension of time (to July 2, 1969) to respond to motion for leave to file amended answer filed. Copies (2) to deft. ALLOWED JUNE 17 1969.
Jul 8 1969	Defendant's amended answer and counterclaim filed. Copies (10) to atty.
Aug 14 1969	Plaintiff's reply to counterclaim filed. Copies (9) to deft.
Nov 19 1969	Court filed order referring case to Commissioner Lloyd Fletcher.
Feb 27 1970	Plaintiff's motion for leave to file amended petition filed. Copies (2) to deft. ALLOWED FEB 27 1970 (amended petition to be filed by March 30, 1970).
Mar 30 1970	Plaintiff's first amended petition filed. Copies (13) to deft.
Apr 29 1970	Defendant's answer to first amended petition filed. Copies (13) to atty.
May 5 1970	Commissioner's standard pretrial order on liability filed. Copy to parties.
Sep 4 1970	Defendant's motion for extension of time (to November 3, 1970) to comply with pretrial order filed. Copies (2) to atty. ALLOWED SEP 4 1970.
Nov 3 1970	Defendant's motion for extension of time (to January 17, 1970) to comply with pretrial order filed. Copies (2) to atty.
Nov 12 1970	Partially allowed in that defendant's time to comply with the pretrial order under Rule 111 is extended to December 28, 1970.
Nov 9 1970	Plaintiff's opposition to motion for time extension filed. Copies (2) to deft.
Dec 28 1970	Defendant's motion for extension of time (to January 12, 1971) to comply with pretrial order filed. Copies (2) to atty. ALLOWED JAN 13 1971.
Jan 11 1971	Defendant's amended motion for extension of time (to January 22, 1971) to comply with pretrial order filed. Copies (2) to atty. ALLOWED JAN 13 1971.
Jan 18 1971	Plaintiff's motion to modify order granting defendant's amended motion for further enlargement of time filed. Copies (2) to deft. DENIED JAN 25 1971 AS MOOT.
Aug 6 1971	Stipulation of facts together with exhibits (attached to the original only) filed by the parties. Copy of stipulation to comr.
Nov 8 1971	Transcript of testimony in one volume (consisting of 181 pages) taken at Washington, D.C. on October 6, 1971 filed. Notice to parties.
Nov 9 1971	Commissioner's order closing proof, etc. filed. Copy to parties. (60–60–20)

Dec 27 1971	Joint motion for leave to file amendments to stipulation of facts and corrections of transcript filed by defendant. Copies (2) to atty. ALLOWED DEC 30 1971.
Dec 30 1971	Correction of transcript filed by defendant. Copies (2) to atty.
Dec 30 1971	Amendment to stipulation of facts filed by defendant. Copies (2) to atty.
Jan 7 1972	Plaintiff's motion for extension of time (to February 7, 1972) to file requested findings, etc. filed. Copies (2) to deft. ALLOWED JAN 10 1972.
Feb 7 1972	Plaintiff's requested findings of fact filed. Copies (2) to deft.
Feb 7 1972	Plaintiff's brief filed. Copies (2) to deft.
Apr 7 1972	Defendant's motion for extension of time (to June 6, 1972) to file findings, etc. filed. Copies (2) to atty. ALLOWED APR 10 1972.
Jun 5 1972	Defendant's motion for extension of time (to July 21, 1972) to file findings, etc. filed. Copies (2) to atty. SEE ENTRY OF JUN 7 1972.
Jun 6 1972	Plaintiff's motion in opposition to motion filed June 5, 1972, filed. Copies (2) to deft.
Jun 7 1972	Re motion of June 5, 1972: Denied in part. Defendant is allowed an extension to June 30, 1972, in which to file brief, requested findings and opposition with no further extension to be granted absent extraordinary cause.
Jun 30 1972	Defendant's motion for extension of time (to July 15, 1972) to file brief filed. Copies (2) to atty. ALLOWED July 3, 1972.
Jul 3 1972	Plaintiff's motion in opposition to defendant's motion for further enlargement of time filed. Copies (2) to deft. DENIED JUL 12 1972.
Jul 17 1972	Defendant's objection to plaintiff's requested findings of fact filed. Copies (2) to atty.
Jul 17 1972	Defendant's requested findindgs of fact filed. Copies (2) to atty.
Jul 17 1972	Defendant's brief to the Commissioner filed. Copies (2) to atty.
Aug 1 1972	Plaintiff's motion for extension of time (to September 11, 1972) to file reply brief, etc., filed. Copies (2) to deft. ALLOWED AUG 2 1972.
Aug 25 1972	Plaintiff's objections to defendant's requested findings, etc. and reply brief for plaintiff filed. Copies (2 of each) to deft.
Jan 15 1973	Notification of change in plaintiff's name [i.e. motion to change caption] (to Penn Security Life Insurance Company) filed. Copies (2) to deft. JAN 31 1973: Notification treated as a motion to identify plaintiff herein by its new name and ALLOWED.

Mar 2 1973	Commissioner's opinion and findings of fact filed. Copies to parties.
Apr 2 1973	Defendant's notice of intention to except filed. Copies (2) to atty.
Apr 13 1973	Defendant's motion for extension of time (to May 31, 1973) to file its exceptions and brief filed. Copies (2) to atty. ALLOWED MAY 7 1975 with no further extension of time to be granted absent a showing of extraordinary cause.
Apr 17 1973	Plaintiff's response to motion for time extension filed. Copies (2) to deft.
Jun 1 1973	Defendant's brief and exceptions filed. Copies (13) to atty. [filed BLOC].
Jul 3 1973	Plaintiff's motion for extension of time (to August 6, 1973) to file brief filed. Copies (2) to deft. ALLOWED JULY 19 1973.
Aug 1 1973	Plaintiff's brief filed. Copies (13) to deft.
Aug 20 1973	Defendant's motion for extension of time (to September 20, 1973) to file reply brief filed. Copies (2) to atty. ALLOWED SEP 7 1973.
Sep 20 1973	Defendant's reply brief filed. Copies (13) to atty.
Dec 5 1973	Argued and submitted on the merits.
Aug 1 1974	Plaintiff's motion for leave to file supplemental statement filed. Copies (2) to deft. ALLOWED AUG 2 1974 provided that defendant is granted to Aug. 29, 1974 to file a response.
Aug 2 1974	Plaintiff's supplemental statement filed. Copies (2) to deft.
Aug 29 1974	Defendant's motion for extension of time (to September 12, 1974) to file response to plaintiff's supplemental statement filed. Copies (2) to atty. ALLOWED SEP 20 1974.
Sept 12 1974	Defendant's motion for extension of time (to September 19, 1974) to file response to plaintiff's supplemental statement filed. Copies (2) to atty. ALLOWED SEP 13 1974.
Sept 18 1974	Defendant's response to plaintiff's supplemental statement filed. Copies (2) to atty.
Dec 18 1974	Court entered order placing this case on the February 1975 Calendar for reargument and submission to the court sitting *en banc*, and further ordering that the parties are to *file simultaneously* on January 17, 1975 supplemental briefs as set forth in the order. Copy to parties and to parties and trial judge in case No. 463–70.
Jan 17 1975	Plaintiff's supplemental brief filed. Copies (3) to deft. and (1) to pltfs. atty. and trial judge in case No. 463–70.

Jan 17 1975	Defendant's supplemental brief filed. Copies (2) to atty. and (1) to pltfs. atty, and trial judge in case No. 463–70.
Jan 20 1975	Plaintiff's consent [to amicus brief] filed. Copies (2) to deft.
Jan 20 1975	Defendant's consent [to amicus brief] filed. Copies (2) to atty.
Jan 20 1975	Brief of Amicus Curiae Consumer Life Insurance Company filed. Copies (2) to parties and (1) to trial judge in case No. 463–70.
Jan 20 1975	Motion of amicus curiae for permission to participate in oral argument filed. Copy to parties. GRANTED JAN 27 1975 in that Consumer Life Insurance Co. may have 15 minutes for oral argument provided that the time allowed plaintiff and defendant for oral argument shall not be changed.
Feb 3 1975	Argued and submitted on the merits [en banc].
Oct 22 1975	Judgment for plaintiff with the amount of recovery to be determined in further proceedings pursuant to Rule 131(c). Opinion Per Curiam. Dissenting opinion by Judge Nichols.
Mar 16 1976	Notice of filing in Supreme Court of a petition for writ of certiorari on March 9, 1976 No. 75–1285, October Term, 1975, filed.
May 27 1976	Order of the Supreme Court, dated May 24, 1976, allowing certiorari filed. Notice to trial judge.
May 27 1976	Record in re certiorari forwarded to Supreme Court.

IN THE UNITED STATES COURT OF CLAIMS

No. 109–68

ITT HAMILTON LIFE INSURANCE COMPANY, A CORPORATION,
PLAINTIFF

v.

THE UNITED STATES OF AMERICA, DEFENDANT

First Amended Petition

(Filed March 30, 1970)

COUNT I

1. Plaintiff claims recovery of income taxes alleged to have been erroneously overpaid and collected under the Internal Revenue Code of 1954 (hereinafter referred to as "the Code")

for the taxable year beginning January 1, 1963, and ending December 31, 1963 (hereinafter referred to as the calendar year 1963). This Court has jurisdiction under 28 U.S.C. sections 1346 (a)(1) and 1491.

2. Plaintiff is a Missouri corporation having its principal office and place of business at 212 South Central Avenue, Clayton, Missouri.

3. (a) Plaintiff was organized and incorporated in the year 1955, under the provisions of Missouri statutes applicable to life insurance companies, for the purpose of engaging in the business of issuing contracts insuring against death or disability occasioned by accident or sickness.

(b) At all material times, the powers granted by plaintiff's Articles of Incorporation, as amended, gave plaintiff the authority necessary to issue contracts insuring against death or disability occasioned by accident or sickness, including contracts reinsuring such risks.

(c) Plaintiff's Articles of Incorporation do not authorize plaintiff to engage in any business other than the business of insuring or reinsuring against death or disability occasioned by accident or sickness, and at all material times plaintiff has engaged solely in such business.

4. During the calendar year 1963, plaintiff was a "Life insurance company" within the meaning of section 801(a) of the Code.

5. During the calendar year 1963, plaintiff's "life insurance reserves" (as referred to in section 801(a)(1) and defined in section 801(b) of the Code) plus plaintiff's unearned premiums and unpaid losses on noncancellable life, health or accident policies not included in life insurance reserves (referred to in section 801(a)(2) of the Code) comprised more than 50 percent of plaintiff's total reserves (as referred to in section 801(a) and defined in section 801(c) of the Code).

6. Pursuant to section 11(d)(2) of the Code (redesignated section 11(e)(2) of the Code by section 121 of P.L. 88–272, effective as of January 1, 1964), plaintiff was subject to Federal income taxation in respect of the calendar year 1963 only under and in the manner provided in section 802 of the Code.

7. For the calendar year 1963, plaintiff timely filed with the District Director of Internal Revenue at St. Louis, Missouri, a Federal income tax return on Treasury Form 1120 L, U.S. Life

Insurance Company tax return computing its taxable income and tax as a life insurance company according to section 802 of the Code, and paid the tax of $479,356.02 shown to be due on the return.

8. The tax shown to be due on plaintiff's return for the calendar year 1963 was overstated in the amount of $143,737.56. The overstatement was due primarily to plaintiff's failure to claim on said return a deduction for "death benefits, etc." in the amount of $120,595.97 to which plaintiff was entitled under section 809(d) of the Code.

9. On August 18, 1967, plantiff filed with the District Director of Internal Revenue at St. Louis, Missouri, a claim for refund, based upon alternative theories, as follows:

(a) On the theory that plaintiff was taxable as an "other Insurance Company" referred to in sections 831 and 832 of the Code, plaintiff computed its tax to be $323,207.52, and claimed a refund of $156,148.50.

(b) On the theory that plaintiff was taxable as a life insurance company under section 802 of the Code, plaintiff computed its tax to be $335,618.46, and claimed refund of $143,737.56. A copy of plaintiff's claim for refund is attached hereto as "Exhibit A", and the facts stated therein are by this reference incorporated herein.

10. Neither the Secretary of the Treasury nor his delegate having theretofore rendered a decision on said claim for refund filed by plaintiff on August 18, 1967, plaintiff, on April 4, 1968, filed suit for a refund of income tax in this Court.

11. On October 24, 1968, after plaintiff had filed a petition claiming a refund of income tax in this Court and prior to the hearing of such suit, the Commissioner of Internal Revenue mailed to plaintiff a statutory notice of deficiency in income tax for the calendar year 1963 in the amount of $307,376.70 and interest thereon in the amount of $99,747.96. The portion of the Statement accompanying the notice of deficiency which purports to explain the assertion of the deficiency reads as follows:

> "It is held that you do not qualify as a life insurance company during the taxable years 1963, 1964 and 1965 within the meaning of Section 801 of the Internal Revenue Code of 1954, per percentage tests as computed in exhibits A and B attached. Your tax liability for these

years has been recomputed, therefore, under the provisions of sections 831 and 832 of the Internal Revenue Code of 1954 as that of an insurance company other than a life or mutual insurance company."

12. Plaintiff did not file a petition with the Tax Court for a redetermination of the asserted deficiency within the time allowed by section 6213(a) of the Code, or at any time thereafter.

13. Defendant did not counterclaim in plaintiff's suit in this Court for the amount of the asserted deficiency, plus interest, within the time provided therefor in section 7422(e) of the Code,

14. On or about February 14, 1969, the Commissioner purported to assess the amount of the asserted deficiency in plaintiff's income tax for the calendar year 1963 of $337,376.70, and the interest thereon in the amount of $99,747.96, and demanded payment thereof.

15. The Commissioner's purported assessment and demand for payment of the said deficiency in income tax and interest was illegal and void in that the United States failed to comply with the procedure provided in section 7422(e) of the Code for the recovery of a deficiency in respect of the same tax which is the subject matter of a suit in this Court.

16. (a) On March 5, 1969, plaintiff paid to the District Director of Internal Revenue, St. Louis, Missouri, the amounts of $337,376.70 and $99,747.96 in respect of the asserted deficiency in plaintiff's income tax for the calendar year 1963, and interest thereon, respectively,

(b) Said payments by plaintiff were made under protest, on the following grounds:

(i) That the purported assessments of said deficiency and interest were illegal and void under Section 7422(e) of the Code; and

(ii) That the determination of said deficiency in any event was erroneous.

17. On April 21, 1969, plaintiff filed with the District Director of Internal Revenue, St. Louis, Missouri, a claim for refund in the amount of $437,124.66 (in addition to the alternative amounts of $156,148.50 or $143,737.56 claimed in plaintiff's claim for refund for the calendar year 1963 filed August 18, 1967). A copy of said claim filed April 21, 1969 is attached

hereto as "Exhibit D", and the facts stated therein are by this reference incorporated herein.

18. On December 3, 1969, plaintiff received from said District Director a formal notice of disallowance of its said claim filed April 21, 1969.

WHEREFORE, plaintiff demands judgment under Count I in the amount of $580,862.2, together with interest and costs as provided by law.

COUNT II.

AN ALTERNATIVE CLAIM IN THE EVENT PLAINTIFF IS HELD NOT TO BE A LIFE INSURANCE COMPANY TAXABLE UNDER SECTION 802 OF THE CODE IN THE CALENDAR YEAR 1963.

1. Plaintiff claims recovery of income taxes alleged to have been erroneously overpaid and collected under the Internal Revenue Code of 1954 (hereinafter referred to as "the Code") for the taxable year beginning January 1, 1963, and ending December 31, 1963 (hereinafter referred to as the calendar year 1963). This Court has jurisdiction under 28 U.S.C. sections 1346(a)(1) and 1491.

2. Plaintiff is a Missouri corporation having its principal office and place of business at 212 South Central Avenue, Clayton, Missouri.

3. (a) Plaintiff was organized and incorporated in the year 1955, under the provisions of Missouri statutes applicable to life insurance companies, for the purpose of engaging in the business of issuing contracts insuring against death or disability occasioned by accident or sickness.

(b) At all material times, the powers granted by plaintiff's Articles of Incorporation, as amended, gave plaintiff the authority necessary to issue contracts insuring against death or disability occasioned by accident or sickness, including contracts reinsuring such risks.

(c) Plaintiff's Articles of Incorporation do not authorize plaintiff to engage in any business other than the business of insuring or reinsuring against death or disability occasioned by accident or sickness, and at all material times plaintiff has engaged solely in such business.

4. During the calendar year 1963, plaintiff was an "insurance company (other than a life or mutual insurance company)" within the meaning of section 831(a)(1) of the Code, and, pursuant to section 11(d)(2) of the Code (redesignated section

11(e)(2) of the Code by section 121 of P.L. 88–272, effective as of January 1, 1964), plaintiff was subject to Federal income taxation in respect of the calendar year 1963 in the manner provided in sections 831 and 832 of the Code.

5. Plaintiff's taxable income as defined in section 832(a) of the Code for the calendar year 1963 was not greater than $636,338.99.

6. For the calendar year 1963, plaintiff timely filed with the District Director of Internal Revenue at St. Louis, Missouri, a Federal income tax return on Treasury Form 1120 L, U.S. Life Insurance Company tax return, computing its taxable income and tax as a life insurance company according to section 802 of the Code, and paid the tax of $479,356.02 shown to be due on the return.

7. On August 18, 1967, plaintiff filed with the District Director of Internal Revenue at St. Louis, Missouri, a claim for refund, based upon alternative theories, as follows:

(a) On the theory that plaintiff was taxable as an "other Insurance Company" referred to in sections 831 and 832 of the Code, plaintiff computed its tax to be $323,207.52, and claimed a refund of $156,148.50.

(b) On the theory that plaintiff was taxable as a life insurance company under section 802 of the Code, plaintiff computed its tax to be $335,618.46, and claimed refund of $143,737.56. A copy of plaintiff's claim for refund is attached hereto as "Exhibit A", and the facts stated therein are by this reference incorporated herein.

8. Neither the Secretary of the Treasury nor his delegate having theretofore rendered a decision on said claim for refund filed by plaintiff on August 18, 1967, plaintiff, on April 4, 1968, filed suit for a refund of income tax in this Court.

9. On October 24, 1968, after plaintiff had filed a petition claiming a refund of income tax in this Court and prior to the hearing of such suit, the Commissioner of Internal Revenue mailed to plaintiff a statutory notice of deficiency in income tax for the calendar year 1963 in the amount of $337,376.70, and interest thereon in the amount of $99,747.96. The portion of the Statement accompanying the notice of deficiency which purports to explain the assertion of the deficiency reads as follows:

> "It is held that you do not qualify as a life insurance company during the taxable years 1963, 1964 and 1965

within the meaning of section 801 of the Internal Revenue Code of 1954, per percentage tests as computed in exhibits A and B attached. Your tax liability for those years has been recomputed, therefore, under the provisions of sections 831 and 832 of the Internal Revenue Code of 1954 as that of an insurance company other than a life or mutual insurance company."

10. Plaintiff did not file a petition with the Tax Court for a redetermination of the asserted deficiency within the time allowed by section 6213(a) of the Code, or at any time thereafter.

11. Defendant did not counterclaim in plaintiff's suit in this Court for the amount of the asserted deficiency, plus interest, within the time provided therefor in section 7422(e) of the Code.

12. On or about February 14, 1969, the Commissioner purported to assess the amount of the asserted deficiency in plaintiff's income tax for the calendar year 1963 of $337,376.70, and interest thereon in the amount of $99,747.96, and demanded payment thereof.

13. The Commissioner's purported assessment and demand for payment of the said deficiency in income tax and interest was illegal and void in that the United States failed to comply with the procedure provided in section 7422(e) of the Code for the recovery of a deficiency in respect of the same tax which is the subject matter of a suit in this Court.

14. (a) On March 5, 1969, plaintiff paid to the District Director of Internal Revenue, St. Louis, Missouri, the amounts of $337,376.70 and $99,747.96 in respect of the asserted deficiency in plaintiff's income tax for the calendar year 1963, and interest thereon, respectively.

(b) Said payments by plaintiff were made under protest, on the following grounds:

(i) That the purported assessments of said deficiency and interest were illegal and void under Section 7422(e) of the Code; and

(ii) That the determination of said deficiency in any event was erroneous.

15. On April 21, 1969, plaintiff filed with the District Director of Internal Revenue, St. Louis, Missouri, a claim for refund in the amount of $437,124.66 (in addition to the alternative amounts of $156,148.50 or $143,737.56 claimed in plaintiff's

claim for refund for the calendar year 1963 filed August 18, 1967). A copy of said claim field April 21, 1969 is attached hereto as "Exhibit D", and the facts stated therein are by this reference incorporated herein.

16. On December 3, 1969, plaintiff received from said District Director a formal notice of disallowance of its said claim filed April 21, 1969.

WHEREFORE, plaintiff demands judgment under Count II in the amount of $593,273.16, together with interest and costs as provided by law.

COUNT III.

1. Plaintiff claims recovery of income taxes alleged to have been erroneously overpaid and collected under the Internal Revenue Code of 1954 (hereinafter referred to as "the Code") for the taxable year beginning January 1, 1964, and ending December 31, 1964 (hereinafter referred to as the calendar year 1964). This Court has jurisdiction under 28 U.S.C. sections 1346(a)(1) and 1491.

2. Plaintiff is a Missouri corporation having its principal office and place of business at 212 South Central Avenue, Clayton, Missouri.

3. (a) Plaintiff was organized and incorporated in the year 1955, under the provisions of Missouri statutes applicable to life insurance companies, for the purpose of engaging in the business of issuing contracts insuring against death or disability, occasioned by accident or sickness.

(b) At all material times, the powers granted by plaintiff's Articles of Incorporation, as amended, gave plaintiff the authority necessary to issue contracts insuring again death or disability occasioned by accident or sickness, including contracts reinsuring such risks.

(c) Plaintiff's Articles of Incorporation do not authorize plaintiff to engage in any business other than the business of insuring or reinsuring against death or disability occasioned by accident or sickness, and at all material times plaintiff has engaged solely in such business.

4. During the calendar year 1964, plaintiff was a "life insurance company" within the meaning of section 801(a) of the Code.

5. During the calendar year 1964, plaintiff's "life insurance reserves" (as referred to in section 801(a)(1) and defined in

section 801(b) of the Code) plus plaintiff's unearned premiums and unpaid losses on noncancellable life, health or accident policies not included in life insurance reserves (referred to in section 801(a)(2) of the Code) comprised more than 50 percent of plaintiff's total reserves (as referred to in section 801(a) and defined in section 801(c) of the Code).

6. Pursuant to section 11(e)(2) of the Code, plaintiff was subject to Federal income taxation in respect of the calendar year 1964 only under and in the manner provided in section 802 of the Code.

7. For the calendar year 1964, plaintiff timely filed with the District Director of Internal Revenue at St. Louis, Missouri, a Federal income tax return on Treasury Form 1120 L, U.S. Life Insurance Company tax return, computing its taxable income and tax as a life insurance company according to section 802 of the Code, and paid the tax of $377,217.70 shown to be due on the return.

8. The tax shown to be due on plaintiff's return for the calendar year 1964 was overstated in the amount of $140,482.78. The overstatement was due primarily to plaintiff's failure to claim on said return a deduction for "death benefits, etc." in the amount of $555,605.11 to which plaintiff was entitled under section 809(d) of the Code.

9. On August 18, 1967, plaintiff filed with the District Director of Internal Revenue at St. Louis, Missouri, a claim for refund in the amount of $140,482.78. A copy of plaintiff's claim for refund is attached hereto as "Exhibit 8", and the facts stated therein are by this reference incorporated herein.

10. Neither the Secretary of the Treasury nor his delegate having theretofore rendered a decision on said claim for refund filed by plaintiff on August 18, 1967, plaintiff, on April 4, 1968, filed suit for a refund of income tax in this Court.

11. On October 24, 1968, after plaintiff had filed a petition claiming a refund of income tax in this Court and prior to the hearing of such suit, the Commissioner of Internal Revenue mailed to plaintiff a statutory notice of deficiency in income tax for the calendar year 1964 in the amount of $362,986.20, and interest thereon in the amount of $85,540.43. The portion of the Statement accompanying the notice of deficiency which

purports to explain the assertion of the deficiency reads as follows:

> "It is held that you do not qualify as a life insurance company during the taxable years 1963, 1964 and 1965 within the meaning of section 801 of the Internal Revenue Code of 1954, per percentage tests as computed in Exhibits A and B attached. Your tax liability for those years has been recomputed, therefore, under the provisions of sections 831 and 832 of the Internal Revenue Code of 1954 as that of an insurance company other than a life or mutual insurance company."

12. Plaintiff did not file a petition with the Tax Court for a redetermination of the asserted deficiency within the time allowed by section 6213(a) of the Code, or at any time thereafter.

13. Defendant did not counterclaim in plaintiff's suit in this Court for the amount of the asserted deficiency, plus interest, within the time provided therefor in section 7422(e) of the Code.

14. On or about February 14, 1969, the Commissioner purported to assess the amount of the asserted deficiency in plaintiff's income tax for the calendar year 1964 of $362,986.20, and the interest thereon in the amount of $85,540.43, and demanded payment thereof.

15. The Commissioner's purported assessment and demand for payment of the said deficiency in income tax and interest was illegal and void in that the United States failed to comply with the procedure provided in section 7422(e) of the Code for the recovery of a deficiency in respect of the same tax which is the subject matter of a suit in this Court.

16. (a) On March 5, 1969, plaintiff paid to the District Director of Internal Revenue, St. Louis, Missouri, the amounts of $362,986.20 and $85,540.43 in respect of the asserted deficiency in plaintiff's income tax for the calendar year 1964, and interest thereon, respectively.

(b) Said payments by plaintiff were made under protest, on the following grounds:

> (i) That the purported assessments of said deficiency and interest were illegal and void under section 7422(e) of the Code; and

(ii) That the determination of said deficiency in any event was erroneous.

17. On April 21, 1969, plaintiff filed with the District Director of Internal Revenue, St. Louis, Missouri, a claim for refund in the amount of $448,526.63 (in addition to the amount of $148,-482.78 claimed in its prior claim for refund for the calendar year 1964 filed August 18, 1967). A copy of said claim filed on April 21, 1969 is attached hereto, marked "Exhibit E", and the facts stated therein are by this reference incorporated herein.

18. On December 3, 1969, plaintiff received from said District Director a formal notice of disallowance of its said claim filed April 21, 1969.

WHEREFORE, plaintiff demands judgment under Count III in the amount of $589,009.41, together with interest and costs as provided by law.

COUNT IV.

1. Plaintiff claims recovery of income taxes alleged to have been erroneously overpaid and collected under the Internal Revenue Code of 1954 (hereinafter referred to as "the Code") for the taxable year beginning January 1, 1965, and ending December 31, 1965, (hereinafter referred to as the calendar year 1965). This Court has jurisdiction under 28 U.S.C. sections 1346(a)(1) and 1491.

2. Plaintiff is a Missouri corporation having its principal office and place of business at 212 South Central Avenue, Clayton, Missouri.

3. (a) Plaintiff was organized and incorporated in the year 1955, under the provisions of Missouri statutes applicable to life insurance companies, for the purpose of engaging in the business of issuing contracts insuring against death or disability occasioned by accident or sickness.

(b) At all material times, the powers granted by plaintiff's Articles of Incorporation, as amended, gave plaintiff the authority necessary to issue contracts insuring against death or disability occasioned by accident or sickness, including contracts reinsuring such risks.

(c) Plaintiff's Articles of Incorporation do not authorize plaintiff to engage in any business other than the business of insuring or reinsuring against death or disability occasioned by accident or sickness, and at all material times plaintiff has engaged solely in such business.

4. During the calendar year 1965, plaintiff was a "life insurance company" within the meaning of section 801(a) of the Code.

5. During the calendar year 1965, plaintiff's "life insurance reserves" (as referred to in section 801(a)(1) and defined in section 801(b) of the Code), plus plaintiff's unearned premiums and unpaid losses on noncancellable life, health or accident policies not included in life insurance reserves (referred to in section 801(a)(2) of the Code) comprised more than 50 percent of plaintiff's total reserves (as referred to in section 801(a) and defined in section 801(c) of the Code).

6. Pursuant to section 11(e)(2) of the Code plaintiff was subject to Federal income taxation in respect of the calendar year 1965 only under and in the manner provided in section 802 of the Code.

7. For the calendar year 1965, plaintiff timely filed with the District Director of Internal Revenue at St. Louis, Missouri, a Federal income tax return on Treasury Form 1120 L, U.S. Life Insurance Company tax return, computing its taxable income and tax as a life insurance company according to section 802 of the Code, and paid the tax of $467,266.14 shown to be due on the return.

8. The tax shown to be due on plaintiff's return for the calendar year 1965, was overstated in the amount of $47,252.76. The overstatement was due primarily to an overstatement of gross premiums earned by plaintiff during the calendar year 1965.

9. On August 18, 1967, plaintiff filed with the District Director of Internal Revenue at St. Louis, Missouri, a claim for refund in the amount of $47,252.76. A copy of plaintiff's claim for refund is attached hereto as "Exhibit C", and the facts stated therein are by this reference incorporated herein.

10. Neither the Secretary of the Treasury nor his delegate having theretofore rendered a decision on said claim for refund filed by plaintiff on August 18, 1967, plaintiff, on April 4, 1968, filed suit for a refund of income tax in this Court.

11. On October 24, 1968, after plaintiff had filed a petition claiming a refund of income tax in this Court and prior to the hearing of such suit, the Commissioner of Internal Reveune mailed to plaintiff a statutory notice of deficiency in income tax for the calendar year 1965 in the amount of $265,412.05, and in-

terest thereon in the amount of $46,621.63. The portion of the Statement accompanying the notice of deficiency which purports to explain the assertion of the deficiency reads as follows:

> "It is held that you do not qualify as a life insurance company during the taxable years 1963, 1964 and 1965 within the meaning of Section 801 of the Internal Revenue Code of 1954, per percentage tests as computed in exhibits A and B attached. Your tax liability for those years has been recomputed, therefore, under the provisions of sections 931 and 932 of the Internal Revenue Code of 1954 as that of an insurance company other than a life or mutual insurance company."

12. Plaintiff did not file a petition with the Tax Court for a redetermination of the asserted deficiency within the time allowed by section 6213(a) of the Code, or at any time thereafter.

13. Defendant did not counterclaim in plaintiff's suit in this Court for the amount of the asserted deficiency, plus interest, within the time provided therefor in section 7422(e) of the Code.

14. On or about February 14, 1969, the Commissioner purported to assess the amount of the asserted deficiency in plaintiff's income tax for the calendar year 1965 of $265,412.05, and the interest thereon in the amount of $46,621.63, and demanded payment thereof.

15. The Commissioner's purported assessment and demand for payment of the said deficiency in income tax and interest was illegal and void in that the United States failed to comply with the procedure provided in section 7422(e) of the Code for the recovery of a deficiency in respect of the same tax which is the subject matter of a suit in this Court.

16. (a) On March 5, 1969, plaintiff paid to the District Director of Internal Revenue, St. Louis, Missouri, the amounts of $265,412.05 and $46,621.63 in respect of the asserted deficiency in plaintiff's income tax for the calendar year 1965, and interest thereon, respectively.

(b) Said payments by plaintiff were made under protest, on the following grounds:

(i) That the purported assessments of said deficiency and interest were illegal and void under section 7422(e) of the Code; and

(ii) That the determination of said deficiency in any event was erroneous.

17. On April 21, 1969, plaintiff filed with the District Director of Internal Revenue, St. Louis, Missouri, a claim for refund in the amount of $312,033.68 (in addition to the amount of $47,252.76 claimed in its prior claim for refund for the calendar year 1965 filed August 18, 1967). A copy of said claim filed April 21, 1969 is attached hereto, marked "Exhibit F", and the facts stated therein are by this reference incorporated herein.

18. On December 3, 1969, plaintiff received from said District Director a formal notice of disallowance of said claim filed April 21, 1969.

WHEREFORE, plaintiff demands judgment under Count IV in the amount of $359,286.44, together with interest and costs as provided by law.

Owen T. Armstrong
OWEN T. ARMSTRONG,
Attorney for Plaintiff.
LOWENHAUPT, CHASNOFF, FREEMAN & HOLLAND
408 Olive Street
St. Louis, Missouri 63102
(314) 241–5950

Of Counsel
JOHN T. SAPIENZA
JOHN B. JONES, JR.
ANDREW W. SINGER
Covington & Burling
888 Sixteenth Street, N.W.
Washington, D.C. 20006
(202) 293–3300

Plaintiff's Post Office Address:
ITT Hamilton Life Insurance Company
212 South Central Avenue
Clayton, Missouri 63105

EXHIBIT A

FORM 843 (Rev. July 1963)

U.S. TREASURY DEPARTMENT INTERNAL REVENUE SERVICE

CLAIM

TO BE FILED WITH THE DISTRICT DIRECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID

RECEIVED
AUG 18 1967
CONTACT SECTION
DISTRICT DIRECTOR
INTERNAL REVENUE SERVICE
ST. LOUIS, MO.

The District Director will indicate in the block below the kind of claim filed, and fill in, where required.

- ☐ Refund of Taxes Illegally, Erroneously, or Excessively Collected.
- ☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.
- ☐ Abatement of Tax Assessed (not applicable to estate, gift, or chrome taxes).

PLEASE TYPE OR PRINT PLAINLY

Name of taxpayer or purchaser of stamps
ITT Life Insurance Company

Number and street
212 South Central

City, town, state, and ZIP Code
St. Louis, Missouri 63105

Fill in applicable items. Attach letter size sheets if space is not sufficient

a. Your social security number | Wife's number, if joint return | b. If an employer, enter employer identification number
43-0712326

c. District in which return (if any) was filed
St. Louis, Missouri

d. Name and address shown on return, if different from above
American Universal Life Insurance Company
111 South Meramec, Clayton, Missouri 63105

e. Period—If tax is reported on an annual basis, prepare separate form for each taxable year
From January 1, 1963, to December 31, 1963

f. Kind of tax
Income Tax

g. Amount of assessment
$ 479,356.02

Dates of payment
9/13/63 ($150,000.00) 3/13/64 ($99,678.01)
12/ 2/63 ($150,000.00) 6/22/64 ($79,678.01)

h. Date stamps were purchased from Government

i. Amount to be refunded (if income tax, complete computation below)
$ 156,148.50*

j. Amount to be abated (not applicable to income, estate, or gift taxes)
$

k. The statement below sets forth the reasons why this claim should be allowed for the following reasons:

On the theory that the Company is to be taxed as an "Other Insurance Company" under sections 831 and 832 (a theory disputed by the Company), the Company computes the tax as $323,207.52. This is the basis of the amount to be refunded shown at item i. The attached Exhibit A summarizes the changes which produce taxable income.

Being taxable as a Life Insurance Company under sections 801 through 820 (the theory affirmed by the Company), the Company computes the tax as $559,818.40. The attached Exhibit B summarizes the changes from Form 1120L as originally filed for calendar year 1963.

See the attached statement of reasons for claim under each theory.

* or such greater amount as may be legally refundable, with interest.

COMPUTATION OF INCOME TAX REFUND	Income Tax
1. Tax withheld	0
2. Estimated tax paid	300,000.00
3. Tax paid with original return	179,356.02
4. Any additional income tax paid	0
5. Total tax paid (Add lines 1-4)	479,356.02
6. Less: Your computation of correct tax	323,207.52
7. Amount of overpayment	156,148.50
8. Amount previously refunded	0
9. Net overpayment (Enter in item i above)	156,148.50

Under penalties of perjury, I declare that this claim, including any accompanying schedules and statements, has been examined by me and to the best of my knowledge and belief it is true and correct.

Signed ITT Life Insurance Company

Dated Aug. 16, 1967 By Gerald M. Ritter, Vice Pres. & Treas.

SEE INSTRUCTIONS ON REVERSE

FORM 843 (Rev. 7-63)

BEST COPY AVAILABLE

EXHIBIT A

ITT Life Insurance Company Caim for Refund—1963

1. Recomputed gain from operations (See Exhibit B)	$1, 238, 623. 29
2. Small business deduction	9, 831. 89
3. Deduction for A & H and Group Life Premiums	34, 932. 84
4. Increase in claim liability	120, 595, 97
5. Tabular life insurance reserves 12/31/63	733, 027. 00
6. Unearned life insurance premiums 12/31/63	(1, 500, 672. 00)
7. Taxable Income	636, 338. 99

EXHIBIT B

ITT Life Insurance Company Claim for Refund—1963

1. Accrual of discount	$8, 626. 68		
2. Accrued interest 12/31/63			351. 57
3. Net long term capital gain			8, 106. 25
4. Gross premiums			167. 04
5. Increase in reserves			6, 110. 54
6. Death benefits, etc	120, 595. 97		
7. Small business deduction			837. 51
8. Other deductions.	313. 69		
Decrease in gain from operations		$113, 973. 43	
Gain from operations as originally filed		1, 352, 596. 72	
Recomputed gain from operations		1, 238, 623. 29	

Two related changes are:		
9. Amounts subtracted from policyholders surplus	215,947.33	
10. Taxable investment income...		3,636.15

STATEMENT OF REASONS FOR CLAIM

I. *Section 831 Theory*

Taxpayer filed its return on Form 1120L as a life insurance company taxable under Sections 801 and following. The agent has asserted that taxpayer is an insurance company other than life or mutual, taxable under Section 831 and following. Taxpayer contends that if the agent's theory were correct, taxpayer's correct taxable income would be only $636,338.99, the correct tax would be $323,207.52, and taxpayer would be entitled to a refund of $156,148.50. The supporting figures are shown on Exhibit A attached to this claim. The principal element involved in these computations is the spread between life insurance "unearned premiums," the amounts of which taxpayer contends were $556,923.00 at December 31, 1962 (by stipulation in a compromise settlement of tax liability for the year 1962) and $1,500,672.00 at December 31, 1963, as determined under Section 832(b)(4).

II. *Section 801 Theory*

Taxpayer filed its return as a life insurance company, computed its gain from operations to be $1,352,596.72, and its tax to be $479,356.02. Taxpayer now contends that it is entitled to certain adjustments as shown in Exhibit B attached to this claim. The principal item is "death benefits, etc." in the amount of $120,595.97, deductible under Section 809(d), The adjustments shown in Exhibit B result in recomputed gain from operations of $1,238,623.29, and a tax of $335,618.46.

A prior claim in the amount of $60,687.10, involving a similar contention was filed and disallowed.

The tax computation also takes into account that, as a result of a compromise settlement of tax liability for prior years,

taxpayer's policyholders' surplus account as of January 1, 1963, is reduced from $215,947.33 to zero, also as shown on Exhibit B.

EXHIBIT B

Form 843 (Rev. July 1963)

U.S. TREASURY DEPARTMENT INTERNAL REVENUE SERVICE

CLAIM

TO BE FILED WITH THE DISTRICT DIRECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID

RECEIVED
AUG 18 1967
CONTACT SECTION
DISTRICT DIRECTOR
INTERNAL REVENUE SERVICE
ST. LOUIS, MO.

The District Director will indicate in the block below the kind of claim filed, and fill in, where required.

- ☐ Refund of Taxes Illegally, Erroneously, or Excessively Collected.
- ☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.
- ☐ Abatement of Tax Assessed (not applicable to estate, gift, or excise taxes).

PLEASE TYPE OR PRINT PLAINLY

Name of taxpayer or purchaser of stamps
ITT Life Insurance Company

Number and street
212 South Central

City, town, State, Postal ZIP Code
St. Louis, Missouri 63105

Fill in applicable items. Mark (X) all boxes that do not apply.

a. Taxpayer social security number | Wife's number, if joint return | b. If an employer, enter employer identification number
43-0712326

c. District in which return (if any) was filed
St. Louis, Missouri

d. Name and address shown on return, if different from above
American Universal Life Insurance Company
111 South Hanley, Clayton, Missouri 63105

e. Period—if tax was reported on annual basis, prepare separate form for each taxable year
From January 1, 1964 To December 31, 1964

f. Kind of tax
Income Tax

g. Amount of assessment
$ 377,217.70

h. Date of payment
4/14/64($4,430.00), 6/5/64($6,000.00), 9/15/64 ($125,000.00), 12/15/64($220,000.00), 3/15/65($21,787.70)

i. State where return was filed
Corporation

j. Amount to be refunded (if amount less than assessment, complete computation below)
$ 140,482.78*

k. Amount to be abated (not applicable to income, estate, or gift taxes)
$

l. The claimant believes that the taxes should be allowed for the following reasons:

On the theory that the Company is to be taxed as a Life Insurance Company under sections 801 through 820 (a theory affirmed by the Company) the Company computes the tax as $236,734.92. This is the basis of the amount to be refunded shown at item i. The attached Exhibit A summarizes the changes from Form 1120L as originally filed for calendar year 1964

See attached statement of reasons for claim.

*For such greater amount as may be legally refundable, with interest.

COMPUTATION OF INCOME TAX REFUND	Income Tax
1. Tax withheld	0
2. Estimated tax paid	355,430.00
3. Tax paid with original return	21,787.70
4. Any additional amount tax paid	0
5. Total tax paid (Add lines 1-4)	377,217.70
6. Less: Your computation of correct tax	236,734.92
7. Amount of overpayment	140,482.78
8. Amount previously refunded	0
9. Net overpayment (Enter in item i above)	140,482.78

Under penalties of perjury, I declare that this claim, including any accompanying schedules and statements, has been examined by me and to the best of my knowledge and belief it is true and correct.

Signed ITT Life Insurance Company

Dated Aug 15, 1967 By Glenn H. Donlon, Vice Pres & Treas

See instructions on reverse

Form 843 (Rev. 7-63)

EXHIBIT A

ITT Life Insurance Company
Claim for Refund—1964

1. Accrual of discount	$7,547.32		
2. Accrued interest 12/31/63	351.57		
3. Net long term capital gain			$375.00
4. Gross premiums	8,813.36		
5. Death benefits, etc	555,605.11		
6. Increase in reserves			10,931.37
7. Small business deduction			789.89
8. Other deductions	1,032.36		
Decrease in gain from operations		$561,253.46	
Gain from operations as originally filed		1,429,191.57	
Recomputed gain from operations		867,938.11	

STATEMENT OF REASONS FOR CLAIM

Taxpayer filed its return as a life insurance company, computed its gain from operations to be $1,429,191.57, and its tax to be $377,217.70. Taxpayer now contends that it is entitled to certain adjustments as shown in Exhibit A. The principal item is "death benefits, etc." in the amount of $555,605.11 deductible under Section 809(d).

The adjustments shown in Exhibit A result in recomputed gain from operations of $867,938.11 and a tax of $236,734.92.

A prior claim in the amount of $136,162.68, involving a similar contention was filed and disallowed.

EXHIBIT C

Form 843 (Rev. July 1963)

U.S. TREASURY DEPARTMENT INTERNAL REVENUE SERVICE

CLAIM

TO BE FILED WITH THE DISTRICT DIRECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID

RECEIVED
AUG 18 1967
CONTACT SECTION
DISTRICT DIRECTOR
INTERNAL REVENUE SERVICE
ST. LOUIS, MO.

The District Director will indicate in the block below the kind of claim filed, and fill in, where required.

- ☐ Refund of Taxes Illegally, Erroneously, or Excessively Collected.
- ☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.
- ☐ Abatement of Tax Assessed (not applicable to estate, gift, or income taxes).

PLEASE TYPE OR PRINT PLAINLY

Name of taxpayer or purchaser of stamps
ITT Life Insurance Company

Number and street
212 South Central

City, town, State, Postal ZIP Code
St. Louis, Missouri 63105

Fill in applicable items—Attach further size sheets if space is not sufficient

a. Your social security number | Wife's number, if joint return | b. If an employer, enter employer identification number
43-0712360

c. District in which return (if any) was filed
St. Louis, Missouri

d. Name and address shown on return, if different from above
American Universal Life Insurance Company
111 South Bemiss, Clayton, Missouri 63105

e. Period—if tax was reported on annual basis, prepare separate form for each taxable year
From January 1, 1965 To December 31, 19 65

f. Kind of tax
Income Tax

g. Amount of assessment
$ 497,260.14

Dates of payment
4/14/65 ($10,000.00), 6/14/65 ($10,000.00), 9/8/65 ($100,000.00), 12/6/65 ($100,000.00), 3/14/66 ($117,633.07).

h. Date stamps were purchased from Government

i. Amount to be refunded (if income tax, complete computation below)
$ 47,252.76*

j. Amount to be abated (not applicable to income, estate, or gift taxes)
$

6/13/66 ($117,633.07).

k. The claimant believes that this claim should be allowed for the following reasons:

On the theory that the Company is to be taxed as a Life Insurance Company under sections 801 through 820 (a theory affirmed by the Company), the Company computed the tax as $470,013.36. This is the basis of the amount to be refunded shown at item i. The attached Exhibit A summarizes the changes from Form 1120L as originally filed for calendar year 1965.

See attached Statement of Reasons for Claim.

*or such greater amount as may be legally refundable, with interest.

COMPUTATION OF INCOME TAX REFUND	Income Tax
1. Tax withheld	0
2. Estimated tax paid	232,000.00
3. Tax paid with original return	235,260.14
4. Any additional income tax paid	0
5. Total tax paid (Add lines 1–4)	497,260.14
6. Less: Your computation of correct tax	420,013.38
7. Amount of overpayment	47,252.76
8. Amount previously refunded	0
9. Net overpayment (Enter on item i above)	47,252.76

Under penalties of perjury, I declare that this claim, including any accompanying schedules and statements, has been examined by me and to the best of my knowledge and belief it is true and correct.

Signed ITT Life Insurance Company

Date Aug 18, 1967 By Edward M. Lawton, Vice-Pres. & Treas.

SEE INSTRUCTIONS ON REVERSE

FORM 843 (Rev. 7-63)

EXHIBIT A

ITT Life Insurance Company Claim for Refund—1965

1. Accrual of discount	$8,795.14		
2. Accrued interest 12/31/65	28,828.32		
3. Accrued interest purchased	1,452.50		
4. Net long term capital gain			4,734.37
5. Gross premiums	121,100.08		
6. Death benefits, etc	30,000.00		
7. Increase in reserves			2,679.94
8. Small business deduction			3,065.75
9. Other deductions	558.01		
Decrease in gain from operations		$180,253.99	
Gain from operations as originally filed		1,839,700.09	
Recomputed gain from operations		1,659,446.10	

STATEMENT OF REASONS FOR CLAIM

Taxpayer filed its return as a life insurance company, computed its gain from operations to be $1,839,700.09 and its tax to be $467,266.14. Taxpayer now contends that it is entitled to certain adjustments as shown in Exhibit A. The principal item is a reduction of gross premiums, resulting from corrections of the amounts of unearned premiums on accident and health insurance at the beginning and end of the taxable period, respectively.

The adjustments shown in Exhibit A result in recomputed gain from operations of $1,659,466.10, and a tax of $420,013.38.

Exhibit D

FORM 843 (Rev. July 1963)

U.S. TREASURY DEPARTMENT - INTERNAL REVENUE SERVICE

CLAIM

TO BE FILED WITH THE DISTRICT DIRECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID

District Director's Stamp (Date Received)

RECEIVED
APR 21 1969
DIRECTOR INT REV
ST. LOUIS

The District Director will indicate in the block below the kind of claim filed, and fill in, where required.

- ☐ Refund of Taxes Illegally, Erroneously, or Excessively Collected.
- ☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.
- ☐ Abatement of Tax Assessed (not applicable to estate, gift, or income taxes).

43

PLEASE TYPE OR PRINT PLAINLY

Name of taxpayer or purchaser of stamps
ITT Hamilton Life Insurance Company

Number and street
212 South Central Avenue

City, town, State, Postal ZIP Code
St. Louis, Missouri 63105

Fill in applicable items—Attach letter size sheets if space is not sufficient

a. Your social security number | Wife's number, if joint return | b. If an employer, enter employer identification number
43-0712326

c. District in which return (if any) was filed
St. Louis, Missouri

d. Name and address shown on return, if different from above
American Universal Life Insurance Company
111 South Meramec, Clayton, Missouri 63105

e. Period—if for tax reported on annual basis, prepare separate form for each taxable year
From January 1, 1963 To December 31, 1963

f. Kind of tax
Income

g. Amount of assessment
$ 437,124.66

Dates of payment
March 5, 1969

h. Date stamps were purchased from Government

i. Amount to be refunded (if income tax, complete computation below)
$ 437,124.66 * #

j. Amount to be abated (not applicable to income, estate, or gift taxes)
$

k. The claimant believes that this claim should be allowed for the following reasons:

See statement attached.

*plus $156,148.50 per claim filed August 18, 1967, or such greater amount as may be legally refundable, with statutory interest.

COMPUTATION OF INCOME TAX REFUND	Income Tax
1. Tax withheld	0
2. Estimated tax paid	300,000.00
3. Tax paid with original return	179,350.02
# 4. Any additional income tax paid including $99,747.96 assessed interest	437,124.66
5. Total tax paid (Add lines 1-4)	916,474.68
6. Less: Your computation of correct tax	323,207.52
7. Amount of overpayment	593,273.16
8. Amount ~~overpaid~~ to be refunded per claim filed 8/18/67	156,148.50
9. Net overpayment (Enter on item i above) claimed herein	437,124.66

Under penalties of perjury, I declare that this claim, including any accompanying schedules and statements, has been examined by me and to the best of my knowledge and belief it is true and correct

Signed ITT HAMILTON LIFE INSURANCE COMPANY
(and on behalf of the above)

Dated April 18, 1969 By: Robert Ritter, Chief Executive Officer

SEE INSTRUCTIONS ON REVERSE

FORM 843 (Rev. 7-63)

STATEMENT OF REASONS FOR CLAIM

1. On March 5, 1969, taxpayer paid $437,124.66 to the District Director of Internal Revenue, St. Louis, Missouri, consisting of $337,376.70 in tax, and $99,747.96 in assessed interest, pursuant to notice and demand for payment. Said payment was made under protest on the following grounds, which constitute the first reason for this claim for refund.

On August 18, 1967, taxpayer filed a claim for refund of $156,148.50 in 1963 income taxes. No action having been taken by the Secretary or his delegate to allow or disallow said claim, taxpayer on April 4, 1968, filed suit for refund in the United States Court of Claims. Said suit is now pending, No. 109–68.

On October 24, 1968, at a time when said suit for refund was pending, the Commissioner of Internal Revenue mailed to taxpayer a statutory notice of deficiencies, including a deficiency in income tax for the year 1963 in the amount of $337,376.70. After the lapse of more than 90 days from and after October 24, 1968, the Commissioner purported to assess said deficiency, notice of said alleged assessment was given and demand for payment thereof was made.

Section 7422(e), Internal Revenue Code of 1954, provides in material part as follows:

> "If the Secretary or his delegate prior to the hearing of a suit brought by a taxpayer in * * * the Court of Claims for the recovery of any income tax * * * mails to the taxpayer a notice that a deficiency has been determined in respect of the tax which is the subject matter of taxpayer's suit, the proceedings in taxpayer's suit shall be stayed during the period of time in which the taxpayer may file a petition with the Tax Court for a redetermination of the asserted deficiency, and for 60 days thereafter. * * * If the taxpayer does not file a petition with the Tax Court for a redetermination of the asserted deficiency, the United States may counterclaim in the taxpayer's suit * * * within the period of the stay of proceedings. * * *"

As applied to this case, this means that the proceedings in taxpayer's Court of Claims Suit No. 109–68 were stayed until March 23, 1969, and the United States might have counterclaimed for the aforementioned asserted deficiency at any time

after January 22 and/on or prior to March 23, 1969. It did not do so.

Therefore, taxpayer contends that said alleged assessment of deficiency pursuant to notice and demand for payment of which taxpayer, on March 5, 1969, paid under protest the said sum of $437,124.66, is illegal and void, the sole legal means of collection of said asserted deficiency having been by counterclaim in said Court of Claims suit, as provided in Section 7422(e).

2. Secondly the Commissioner erred in determining said deficiency of $337,376.70, of which notice was given October 24, 1968. Said determination is predicated upon the holding that taxpayer for its taxable year ended December 31, 1963, did not qualify as a life insurance company within the meaning of Section 801 of the Internal Revenue Code of 1954, but was taxable under Sections 831 and 832 as an insurance company other than a life or mutual insurance company. Taxpayer contends that it did qualify as a life insurance company under the statutory test, and is therefore taxable as such for the year 1963.

Exhibit E

Form 843 (Rev. July 1963)

U.S. TREASURY DEPARTMENT - INTERNAL REVENUE SERVICE

CLAIM

TO BE FILED WITH THE DISTRICT DIRECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID

District Director's Stamp (Date Received)

RECEIVED
APR 21 1969
DIRECTOR INT REV
ST. LOUIS
TELLER - #1

The District Director will indicate in the block below the kind of claim filed, and fill in, where required.

- ☐ Refund of Taxes Illegally, Erroneously, or Excessively Collected.
- ☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.
- ☐ Abatement of Tax Assessed (not applicable to estate, gift, or income taxes).

PLEASE TYPE OR PRINT PLAINLY

Name of taxpayer or purchaser of stamps
ITT Hamilton Life Insurance Company

Number and street
212 South Central Avenue

City, town, State, Postal ZIP Code
St. Louis, Missouri 63105

Fill in applicable items—Attach letter size sheets if space is not sufficient

a. Your social security number | Wife's number, if joint return | b. If an employer, enter employer identification number
43-0713325

c. District in which return (if any) was filed
St. Louis, Missouri

d. Name and address shown on return, if different from above
American Universal Life Insurance Company
111 South Meramec, Clayton, Missouri 63105

e. Period—If for tax reported on annual basis, prepare separate form for each taxable year
From January 1, 19 64, to December 31, 19 64

f. Kind of tax
Income

g. Amount of assessment
$ 448,526.63

Dates of payment
March 5, 1969

h. Date stamps were purchased from Government

i. Amount to be refunded (if income tax, complete computation below)
$ 448,526.63 *#

j. Amount to be abated (not applicable to income, estate, or gift taxes)
$

k. The claimant believes that this claim should be allowed for the following reasons:

See statement attached.

*plus $140,482.78 per claim filed August 18, 1967, or such greater amount as may be legally refundable, with statutory interest

COMPUTATION OF INCOME TAX REFUND	Income Tax
1. Tax withheld	0
2. Estimated tax paid	355,430.00
3. Tax paid with original return	21,787.70
# 4. Any additional income tax paid including $85,540.43 assessed interest	448,526.63
5. Total tax paid (Add lines 1-4)	825,744.33
6. Less: Your computation of correct tax	236,734.92
7. Amount of overpayment	589,009.41
8. Amount [illegible] to be refunded per claim filed 8/18/67	140,482.78
9. Net overpayment (Enter in item i above) claimed herein	448,526.63

Under penalties of perjury, I declare that this claim, including any accompanying schedules and statements, has been examined by me and to the best of my knowledge and belief it is true and correct.

Signed ITT HAMILTON LIFE INSURANCE COMPANY

Dated April 18, 19 69 By: Joseph Kutten, Chairman of the Board and Chief Executive Officer

SEE INSTRUCTIONS ON REVERSE

FORM 843 (Rev. 7-65)

STATEMENT OF REASONS FOR CLAIM

1. On March 5, 1969, taxpayer paid $448,526.63 to the District Director of Internal Revenue, St. Louis, Missouri, consisting of $362,986.20 in tax, and $85,540.43 in assessed interest, pursuant to notice and demand for payment. Said payment was made under protest on the following grounds, which constitute the first reason for this claim for refund:

On August 18, 1967, taxpayer filed a claim for refund of $140,482.78 in 1964 income taxes. No action having been taken by the Secretary or his delegate to allow or disallow said claim, taxpayer on April 4, 1968, filed suit for refund in the United States Court of Claims. Said suit is now pending, No. 109–68.

On October 24, 1968, at a time when said suit for refund was pending, the Commissioner of Internal Revenue mailed to taxpayer a statutory notice of deficiencies, including a deficiency in income tax for the year 1964 in the amount of $362,986.20. After the lapse of more than 90 days from and after October 24, 1968, the Commissioner purported to assess said deficiency, notice of said alleged assessment was given and demand for payment thereof was made.

Section 7422(e), Internal Revenue Code of 1954, provides in material part as follows:

> "If the Secretary or his delegate prior to the hearing of a suit brought by a taxpayer in * * * the Court of Claims for the recovery of any income tax * * * mails to the taxpayer a notice that a deficiency has been determined in respect of the tax which is the subject matter of taxpayer's suit, the proceedings in taxpayer's suit shall be stayed during the period of time in which the taxpayer may file a petition with the Tax Court for a redetermination of the asserted deficiency, and for 60 days thereafter. * * * If the taxpayer does not file a petition with the Tax Court for a redetermination of the asserted deficiency, the United States may counterclaim in the taxpayer's suit * * * within the period of the stay of proceedings * * *."

As applied to this case, this means that the proceedings in taxpayer's Court of Claims Suit No. 109–68 were stayed until March 23, 1969, and the United States might have counterclaimed for the aforementioned asserted deficiency at any time after January 22 and on or prior to March 23, 1969. It did not do so.

Taypayer contends, therefore, that said alleged assessment of deficiency pursuant to notice and demand for payment of which taxpayer, on March 5, 1968, paid under protest the said sum of $448,526.63, is illegal and void, the sole legal means of collection of said asserted deficiency having been by counterclaim in said Court of Claims suit, as provided in Section 7422(e).

2. Secondly, the Commissioner erred in determining said deficiency of $362,986.20, of which notice was given October 24, 1968. Said determination is predicated upon the holding that taxpayer for its taxable year ended December 31, 1964, did not qualify as a life insurance company within the meaning of Section 801 of the Internal Revenue Code of 1954, but was taxable under Sections 831 and 832 as an insurance company other than a life or mutual insurance company. Taxpayer contends that it did qualify as a life insurance company under the statutory test and is therefore taxable as such for the year 1964.

214-447—76——3

Exhibit F

FORM 843 (Rev. July 1968)

U.S. TREASURY DEPARTMENT - INTERNAL REVENUE SERVICE

CLAIM

TO BE FILED WITH THE DISTRICT DIRECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID.

Internal Revenue Service Stamp (date received)

RECEIVED
APR 21 1969
DIRECTOR INT REV
ST. LOUIS
TELLER - 52

The District Director will indicate in the block below the kind of claim filed, and list no. where required.

- ☐ Refund of Taxes Illegally, Erroneously, or Excessively Collected.
- ☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.
- ☐ Abatement of Tax Assessed (not applicable to estate, gift, or income taxes).

PLEASE TYPE OR PRINT PLAINLY

43

Name of taxpayer or purchaser of stamps
ITT Hamilton Life Insurance Company

Number and street
212 South Central Avenue

City, town, State, Postal ZIP Code
St. Louis, Missouri 63105

Fill in applicable items—Attach letter size sheets if space is not sufficient

a. Your social security number | b. Claim number (if given to you) | c. Employer identification number
43-0712320

d. District in which return (if any) was filed
St. Louis, Missouri

d. Name and address shown on return, if different from above
American Universal Life Insurance Company
111 South Meramec, Clayton, Missouri 63105

e. Period—if tax reported on annual basis, prepare separate form for each taxable year
From January 1 1965 To December 31 1965

f. Kind of tax
Income

g. Amount of assessment
$ 312,033.68

Dates of payment
March 5, 1969

h. Date stamps were purchased from Government

i. Amount to be refunded (if income tax, complete computation below)
$ 312,033.68 *#

j. Amount to be abated (not applicable to income, estate, or gift taxes)
$

k. The claimant believes that this claim should be allowed for the following reasons:

See statement attached.

*plus $47,252.76 per claim filed August 18, 1967, or such greater amount as may be legally refundable, with statutory interest

COMPUTATION OF INCOME TAX REFUND	Income Tax
1. Tax withheld	0
2. Estimated tax paid	232,000.00
3. Tax paid with original return	235,200.14
# 4. Any additional income tax paid including $46,621.63 assessed interest	312,033.95
5. Total tax paid (Add lines 1-4)	779,234.09
6. Less: Your computation of correct tax	420,013.38
7. Amount of overpayment	359,220.71
8. Amount to be refunded per claim filed 8/18/67	47,252.76
9. Net overpayment (Enter in item i above) claimed herein	312,033.68

Under penalties of perjury, I declare that this claim, including any accompanying schedules and statements, has been examined by me and to the best of my knowledge and belief it is true and correct.

Signed ITT HAMILTON LIFE INSURANCE COMPANY
CHAIRMAN OF THE BOARD AND
Dated APRIL 8, 1969 By: JOSEPH KUTTEN CHIEF EXECUTIVE OFFICER

SEE INSTRUCTIONS ON REVERSE

FORM 843 (Rev. 7-68)

STATEMENT OF REASONS FOR CLAIM

1. On March 5, 1969, taxpayer paid $312,033.68 to the District Director of Internal Revenue, St. Louis, Missouri,

consisting of $265,412.05 in tax, and $46,621.63 in assessed interest, pursuant to notice and demand for payment. Said payment was made under protest on the following grounds, which constitute the first reason for this claim for refund.

On August 18, 1967, taxpayer filed a claim for refund of $47,252.76 in 1965 income taxes. No action having been taken by the Secretary or his delegate to allow or disallow said claim, taxpayer on April 4, 1968, filed suit for refund in the United States Court of Claims. Said suit is now pending, No. 109-68.

On October 24, 1968, at a time when said suit for refund was pending, the Commissioner of Internal Revenue mailed to taxpayer a statutory notice of deficiencies, including a deficiency in income tax for the year 1965 in the amount of $265,412.05. After the lapse of more than 90 days from and after October 24, 1968, the Commissioner purported to assess said deficiency, notice of said alleged assessment was given and demand for payment thereof was made.

Section 7422(e), Internal Revenue Code of 1954, provides in material part as follows:

> "If the Secretary or his delegate prior to the hearing of a suit brought by a taxpayer in * * * the Court of Claims for the recovery of any income tax * * * mails to the taxpayer a notice that a deficiency has been determined in respect of the tax which is the subject matter of taxpayer's suit, the proceedings in taxpayer's suit shall be stayed during the period of time in which the taxpayer may file a petition with the Tax Court for a redetermination of the asserted deficiency, and for 60 days thereafter. * * * If the taxpayer does not file a petition with the Tax Court for a redetermination of the asserted deficiency, the United States may counterclaim in the taxpayer's suit * * * within the period of the stay of proceeding * * * ."

As applied to this case, this means that the proceedings in taxpayer's Court of Claims Suit No. 109-68 were stayed until March 23, 1969, and the United States might have counterclaimed for the aforementioned asserted deficiency at any time after January 22 and on or prior to March 23, 1969. It did not do so.

Taxpayer contends, therefore, that said alleged assessment of deficiency pursuant to notice and demand for payment of which taxpayer on March 5, 1968, paid under protest the said sum of $312,033.68, is illegal and void, the sole legal means of collection of said asserted deficiency having been by counterclaim in said Court of Claims suit, as provided in Section 7422(e).

2. Secondly, the Commissioner erred in determining said deficiency of $265,412.05, of which notice was given October 24, 1968. Said determination is predicated upon the holding that taxpayer for its taxable year ended December 31, 1965, did not qualify as a life insurance company within the meaning of Section 801 of the Internal Revenue Code of 1954, but was taxable under Sections 831 and 832 as an insurance company other than a life or mutual insurance company. Taxpayer contends that it did qualify as a life insurance company under the statutory test, and is therefore taxable as such for the year 1965.

Answer to First Amended Petition

(Number and title omitted.)

(Filed: April 29, 1970)

Defendant, the United States of America, in answer to the First Amended Petition filed in the above-entitled action, denies each and every allegation contained therein, not admitted, qualified, or expressly referred to below:

Defendant further:

COUNT I

1. Admits paragraph 1, but denies that income taxes, the recovery of which is claimed by plaintiff, were overpaid for the calendar year 1963.

2. Admits the allegations contained in paragraph 2.

3. States that it is presently unable to obtain knowledge or information sufficient to form a belief concerning the truth of the allegations contained in paragraph 3.

4. Denies the allegations contained in paragraph 4.

5. Denies the allegations contained in paragraph 5.

6. Denies the allegations contained in paragraph 6.

7. Admits the allegations contained in paragraph 7.

8. Denies the allegations contained in paragraph 8.

9. Admits the allegations contained in paragraph 9, but denies that income taxes the recovery of which is claimed by the plaintiff constituted an overpayment of income tax for the year 1963.

10. Admits the allegations contained in paragraph 10.

11. Admits the allegations contained in paragraph 11.

12. Admits the allegations contained in paragraph 12.

13. Denies the allegations contained in paragraph 13, and further alleges that—

(a) defendant filed a counterclaim which was incorporated in an Amended Answer filed on April 25, 1969,

(b) the counterclaim was filed within the time provided therefor in Section 7422(e) of the Code,

(c) plaintiff filed a Reply To Counterclaim on August 14, 1969, in which it alleged that the amount claimed in the defendant's counterclaim had previously been paid by the plaintiff,

(d) since the plaintiff has paid the taxes for which the counterclaim was filed and amended its petition to include a claim for refund of these taxes, a counterclaim by the defendant is no longer necessary, nor required by law.

14. Admits the allegations contained in paragraph 14, and alleges further that an assessment was, in fact, made on February 14, 1969.

15. Denies the allegations contained in paragraph 15.

16. Admits the allegations contained in paragraph 16.

17. Admits the allegations contained in paragraph 17, but denies that income taxes the recovery of which is claimed by plaintiff constituted an overpayment of income tax for the calendar year 1963.

18. Admits the allegations contained in paragraph 18.

COUNT II

1. Admits the allegations contained in paragraph 1, but denies that income taxes the recovery of which is claimed by plaintiff were overpaid for the calendar year 1963.

2. Admits the allegations contained in paragraph 2.

3. States that it is presently unable to obtain knowledge or information sufficient to form a belief concerning the truth of the allegations contained in paragraph 3.

4. Admits the allegations contained in paragraph 4.

5. States that it is presently unable to obtain knowledge or information sufficient to form a belief concerning the truth of the allegations contained in paragraph 5.

6. Admits the allegations contained in paragraph 6.

7. Admits the allegations contained in paragraph 7, but denies that income taxes the recovery of which is claimed by plaintiff constituted an overpayment of income tax for the calendar year 1963.

8. Admits the allegations contained in paragraph 8.

9. Admits the allegations contained in paragraph 9.

10. Admits the allegations contained in paragraph 10.

11. Denies the allegations contained in paragraph 11, and further alleges that—

(a) defendant filed a counterclaim which was incorporated in an Amended Answer filed on April 25, 1969,

(b) the counterclaim was filed within the time provided therefor in Section 7422(e) of the Code,

(c) plaintiff filed a Reply To Counterclaim on August 14, 1969, in which it alleged that the amount claimed in the defendant's counterclaim had previously been paid by the plaintiff,

(d) since the plaintiff has paid the taxes for which the counterclaim was filed and amended its petition to include a claim for refund of these taxes, a counterclaim by the defendant is no longer necessary, nor required by law.

12. Admits the allegations contained in paragraph 12, and alleges further that an assessment was, in fact, made on February 14, 1969.

13. Denies the allegations contained in paragraph 13.

14. Admits the allegations contained in paragraph 14.

15. Admits the allegations contained in paragraph 15, but denies that amounts of income tax the recovery of which is claimed by plaintiff constituted an overpayment of income tax for the calendar year 1963.

16. Admits the allegations contained in paragraph 16.

COUNT III

1. Admits paragraph 1, but denies that income taxes the recovery of which is claimed by plaintiff were overpaid for the calendar year 1964.

2. Admits the allegations contained in paragraph 2.

3. States that it is presently unable to obtain knowledge or information sufficient to form a belief concerning the truth of the allegations contained in paragraph 3.

4. Denies the allegations contained in paragraph 4.

5. Denies the allegations contained in paragraph 5.

6. Denies the allegations contained in paragraph 6.

7. Admits the allegations contained in paragrah 7.

8. Denies the allegations contained in paragraph 8.

9. Admits the allegations contained in paragraph 9.

10. Admits the allegations contained in paragraph 10.

11. Admits the allegations contained in paragraph 11.

12. Admits the allegations contained in paragraph 12.

13. Denies the allegations contained in paragraph 13, and further alleges that—

(a) defendant filed a counterclaim which was incorporated in an Amended Answer filed on April 25, 1969,

(b) the counterclaim was filed within the time provided therefor in Section 7422(e) of the Code,

(c) plaintiff filed a Reply To Counterclaim on August 14, 1969, in which it alleged that the amount claimed in the defendant's counterclaim had previously been paid by the plaintiff,

(d) since the plaintiff has paid the taxes for which the counterclaim was filed and amended its petition to include a claim for refund of these taxes, a counterclaim by the defendant is no longer necessary, nor required by law.

14. Admits the allegations contained in paragraph 14, and alleges further that an assessment was, in fact, made on February 14, 1969.

15. Denies the allegations contained in paragraph 15.

16. Admits the allegations contained in paragraph 16.

17. Admits the allegations contained in paragraph 17, but denies that income taxes the recovery of which is claimed

by plaintiff constituted an overpayment of income tax for the calendar year 1964.

18. Admits the allegations contained in paragraph 18.

COUNT IV

1. Admits paragraph 1, but denies that income taxes the recovery of which is claimed by plaintiff were overpaid for the calendar year 1965.

2. Admits the allegations contained in paragraph 2.

3. States that it is presently unable to obtain knowledge or information sufficient to form a belief concerning the truth of the allegations contained in paragraph 3.

4. Denies the allegations contained in paragraph 4.

5. Denies the allegations contained in paragraph 5.

6. Denies the allegations contained in paragraph 6.

7. Admits the allegations contained in paragraph 7.

8. Denies the allegations contained in paragraph 8.

9. Admits the allegations contained in paragraph 9, but denies that income taxes the recovery of which is claimed by the plaintiff constituted an overpayment of income tax for the calendar year 1965.

10. Admits the allegations contained in paragraph 10.

11. Admits the allegations contained in paragraph 11.

12. Admits the allegations contained in paragraph 12.

13. Denies the allegations contained in paragraph 13, and further alleges that—

(a) defendant filed a counterclaim which was incorporated in an Amended Answer filed on April 25, 1969,

(b) the counterclaim was filed within the time provided therefor in Section 7422(e) of the Code,

(c) plaintiff filed a Reply To Counterclaim on August 14, 1969, in which it alleged that the amount claimed in the defendant's counterclaim had previously been paid by the plaintiff,

(d) since the plaintiff has paid the taxes for which the counterclaim was filed and amended its petition to include a claim for refund of these taxes, a counterclaim by the defendant is no longer necessary, nor required by law.

14. Admits the allegations contained in paragraph 14, and alleges further that an assessment was, in fact, made on February 14, 1969.

15. Denies the allegations contained in paragraph 15.

16. Admits the allegations contained in paragraph 16.

17. Admits the allegations contained in paragraph 17, but denies that income taxes the recovery of which is claimed by plaintiff constituted an overpayment of income tax for the calendar year 1965.

18. Admits the allegations contained in paragraph 18.

WHEREFORE, defendant prays that the petition be dismissed with cost assessed against plaintiff.

Respectfully submitted,

JOHNNIE M. WALTERS,
Assistant Attorney General.

ROGER A. SCHWARZ,
Attorney.

Stipulation of Fact

(Number and title omitted.)

(Filed: August 6, 1971)

It is hereby stipulated that,, for the purpose of this case, the following statements may be accepted as facts and all exhibits referred to herein and attached hereto are incorporated in this stipulation and made a part hereof, subject to the right of either party to object to the admission of such statements or exhibits in evidence on the grounds of materiality or relevancy.

I. Plaintiff was incorporated on August 8, 1955, under the statutes of the State of Missouri applicable to the organization of life insurance companies. Amended Articles of Incorporation were filed on September 6, 1957. During the years 1963, 1964 and 1965, and at all other relevant times, it was empowered by its Articles of Incorporation and authorized by the insurance authorities of the State of Missouri to engage in the business of insuring and reinsuring

life and health and accident insurance contracts and has carried on such business exclusively.

2. Aetna Finance Company (Aetna) was incorporated in 1924 under the laws of the State of Missouri. Plaintiff became a wholly-owned subsidiary of Aetna in 1959. Prior to 1959, Plaintiff's stock was owned by Richard Yalem and Carolyn Kutten, the son and daughter of Charles H. Yalem, the principal stockholder of Aetna. Some Aetna stock was also held beneficially for Richard and Carolyn in trusts created by Charles H. Yalem.

3. All of Aetna's assets, including the capital stock of Plaintiff and other subsidiary corporations of Aetna, were acquired by International Telephone and Telegraph Corporation (IT&T) on August 31, 1964, and Aetna was subsequently dissolved. IT&T transferred Aetna's assets to ITT Aetna Corporation, an IT&T subsidiary, as a contribution to capital. In 1966, ITT Aetna's stock was transferred to ITT Consumer Services Corporation, another subsidiary of IT&T. (References made hereafter to "Aetna" refer to Aetna Finance Company for the period on or before August 31, 1964, and to ITT Aetna Corporation for the period after August 31, 1964, where appropriate.)

4. Plaintiff was originally incorporated under the name American Universal Life Insurance Company, and operated under this name during the years in issue. Its name was changed to ITT Life Insurance Company in 1966 and to ITT Hamilton Life Insurance Company in 1967. The final change in name reflected the combination of Plaintiff's operations with those of the Alexander Hamilton Life Insurance Company, a former IT&T subsidiary which became a subsidiary of Plaintiff in 1966 and was merged into Plaintiff in 1967.

5. Until approximately 1966, Plaintiff's principal business consisted of reinsuring certain insurance companies with respect to credit insurance policies issued by those companies insuring the lives and health of loan customers of Aetna and its finance company subsidiaries. During the years in issue, operating subsidiaries of Aetna had over 200 offices in approximately 25 states engaged in the business of making consumer loans.

6. Credit life insurance, generally defined, is term insurance on the lives of debtors, with their creditors as bene-

ficiaries, in amounts at least sufficient to discharge their indebtedness in case of death. Sometimes the life coverage is combined with the accident and health coverage. Such coverage pays the debtor's monthly installments during the period within the policy term in which he is totally disabled (*i.e.*, unable to work) because of accident or sickness, provided that the disability lasts beyond a minimum or "waiting" period. Sometimes coverage is conditioned upon the permanent as well as total disability of the debtor.

7. Credit life and accident and health insurance is sold usually as a part of another, and more prominent transaction, namely, a loan of money or an installment sale of tangible personal property. Its primary function is to provide a sure, quick, and uncomplicated means for liquidating the balance due on the loan or installment sale in the event of the death of the borrower or purchaser and, where additional health and accident coverage is provided, to pay the borrower's monthly installments while he is unable to work.

8. Credit life and accident and health insurance is written in two different ways: (1) under an individual insurance policy issued directly to the insured debtor, or (2) under a group policy, in which case the beneficiary-creditor is the policy holder and the individual insured debtor simply receives a certificate of insurance. It is generally written for a term which is coextensive with the contractual term of the related indebtedness. Occasionally a company may write a policy with a term of as long as five years, but the average in the industry is two to three years in most instances.

9. Two types of life insurance coverage are provided by credit life insurance, namely: (1) decreasing term coverage (also called declining balance insurance), under which the amount of the death benefit decreases during the policy term, coincidentally with the decrease in the amount of the debt under the applicable installment payment schedule, and (2) level term coverage, under which the amount of the death benefit remains constant during the policy term (a type of coverage particularly suitable where the debt is not payable in regular installments, but, for example, in a lump sum). Benefits under additional accident and health coverage are generally computed in the same manner regardless of whether the life insurance coverage is on a

decreasing term or level term basis. In the event of disability occasioned by accident or sickness, the accident and health coverage pays a monthly indemnity determined by dividing the amount of the loan by the number of months in the term. If the disability lasts for less than a full month (but longer than the minimum waiting period), a proportionate part of the monthly indemnity is paid.

10. Under a standard credit life and accident and health insurance policy, the creditor is the primary beneficiary to the extent of the unpaid balance of the indebtedness account at the time of the insured debtor's death or disability caused by accident or sickness. If, because of prepayment or some other reason, the amount of the death benefit payable under the policy should happen to exceed the balance due on the account, the insured's designated secondary beneficiary receives the excess. In the case of accident and health coverage, if the monthly indemnity exceeds the balance due on the account, the excess would usually be paid to the debtor himself.

11. Like some forms of group insurance, but unlike ordinary whole-life or term insurance, a flat rate for credit life insurance and for accident and health coverage is charged, and an inquiry is generally not made as to the age, health, or medical history of the applicant.

12. Essentially, credit life insurance is simply a specialized form of term life insurance written for a specific purpose as described in paragraph 7, *supra*. Unlike insurance such as fire, public liability, and similar types of casualty insurance, credit life insurance contracts, including those reinsured by Plaintiff, cannot be canceled by the insurance company during the term for which they are written. This remains true where additional accident and health coverage is provided in the credit life insurance policy; that is, neither the credit life coverage nor the credit accident and health coverage can be canceled by the insurance company during the term for which the policy is written.

Refunds to debtors allowable under the terms of credit life, accident and health policies, including those reinsured by Plaintiff, are usually calculated in accordance with the Rule of 78 (see paragraph 26, *infra*.)

13. The premium charge for a life insurance contract is computed so as to cover all the contingencies the insurance company is likely to meet, and these contingencies are generally grouped into three elements, namely, mortality, interest, profit and expenses. Mortality refers to that part of the premium which provides for the occurrence of the *risk* insured against, while the second element takes into account the assumed interest to be earned by the company. The third element primarily covers profit and the cost incident to management of the company, such as salaries, rents, commissions, taxes, and other costs of doing business. In arriving at a premium charge, the first and second step is the computation of what is called a "net premium" which takes into account only the mortality and interest elements. To the net premium is then added an amount called "loading" which is calculated to provide for profit and expenses. The resulting premium, called the "gross premium" is the premium charged to the policyholder.

The premium charge for accident and health insurance coverage is computed similarly to a life insurance premium, except that the mortality element of a life insurance premium is replaced by the "morbidity" element of the accident and health premium (*i.e.*, that part of the premium which provides for the occurrence of the *risk* of the insured becoming disabled because of accident or sickness.)

14. During the years 1963, 1964 and 1965, most of the individual and group credit life and combined credit life, accident and health policies covering the lives and health of debtors of Aetna and its subsidiaries were issued by Old Republic Life Insurance Company of Chicago, Illinois ("Old Republic"), Pilot Life Insurance Company of Greensboro, North Carolina ("Pilot") and National Fidelity Life Insurance Company of Kansas City, Missouri ("National Fidelity"). To a much lesser extent, such credit insurance policies were also issued by Insurance City Life Company ("Insurance City") and by American Bankers Life Assurance Company ("American Bankers"). None of the above insurance companies was owned or controlled, directly or indirectly, by Plaintiff, Aetna, or IT&T.

15. Plaintiff entered into "Life Reinsurance Treaty No. 6" with Old Republic on March 23, 1961, effective as of Janu-

ary 1, 1961, which treaty, as amended, was in force during the years in issue. True and correct copies of this Old Republic credit life reinsurance treaty and subsequent amendments thereto are attached hereto as Exhibit 1.

16. Plaintiff entered into a "Disability Reinsurance Treaty" with Old Republic on March 23, 1961, effective as of January 1, 1961, which treaty, as amended, was in force during the years in issue. True and correct copies of this Old Republic disability reinsurance treaty and subsequent amendments thereto are attached hereto as Exhibit 2.

17. Plaintiff entered into a "Credit Life Reinsurance Agreement" with Pilot on July 2, 1957, effective as of February 1, 1957, which agreement, as amended, was in force during the years in issue. True and correct copies of this Pilot credit life reinsurance treaty and subsequent amendments thereto are attached hereto as Exhibit 3.

18. Plaintiff entered into an "Accident and Health Reinsurance Agreement" with Pilot on July 2, 1957, effective as of July 1, 1957, which agreement, as amended, was in force during the years in issue. True and correct copies of this Pilot credit accident and health reinsurance treaty and subsequent amendments thereto are attached hereto as Exhibit 4.

19. Plaintiff entered into a "Credit Life Reinsurance Agreement" with National Fidelity on July 2, 1957, effective as of February 1, 1957, which agreement, as amended, was in force during the years in issue. True and correct copies of this National Fidelity credit life reinsurance treaty and subsequent amendments thereto are attached hereto as Exhibit 5.

20. Plaintiff entered into an "Accident and Health Reinsurance Agreement" with National Fidelity on July 2, 1957, effective as of July 1, 1957, which agreement, as amended, was in force during the years in issue. True and correct copies of this National Fidelity credit accident and health reinsurance treaty and subsequent amendments thereto are attached hereto as Exhibit 6.

21. Plaintiff entered into a "Reinsurance Agreement" with Insurance City on August 24, 1962, effective as of July 1, 1962, which agreement was in force during the years in issue. A true and correct copy of this Insurance City reinsurance treaty is attached hereto as Exhibit 7.

22. Plaintiff entered into a "Reinsurance Agreement" with American Bankers on October 23, 1959, effective as of Octo-

ber 1, 1959, which agreement was in force during the years in issue. A true and correct copy of this American Bankers reinsurance treaty is attached hereto as Exhibit 8.

23. Plaintiff entered into a separate "Reinsurance Agreement" with Pilot for certain insurance issued by Pilot in North Carolina on March 23, 1962, effective as of April 1, 1962, which agreement was in force during the years in issue. A true and correct copy of this Pilot "North Carolina" reinsurance treaty is attached hereto as Exhibit 9.

24. The policies covered by the above reinsurance treaties provided either credit life insurance only or credit life and credit accident and health coverage combined in a single policy with the same maximum amount of insurance under both coverages (*i.e.*, the amount of the loan). None of the policies provided only credit accident and health coverage (without credit life coverage) with the exception of National Fidelity Policy Form P–825–12–52, which was issued solely in the State of Oklahoma and was always issued in connection with National Fidelity Policy Form P–727–1253 which provided credit life coverage in a corresponding amount. The combined credit life, accident and health policies disclosed separate single premiums for credit life coverage and credit accident and health coverage, and, in the case of policies issued by Old Republic, Pilot and National Fidelity, such coverages were reinsured with Plaintiff under separate reinsurance treaties (except for the treaty reinsuring policies issued by Pilot in North Carolina, which included both credit life and credit accident and health coverages) as described above. All of the policies reinsured under the above reinsurance treaties during the years in issue provided for the payment of a single premium at the inception of the insurance coverage. Attached hereto and marked Exhibits 10 to 16 are typical individual and group credit life and credit life, accident and health certificates and policies issued by Old Republic, Pilot, National Fidelity and Insurance City during the years in issue and reinsured by Plaintiff under the above reinsurance treaties.

25. When a credit accident and health premium under a single premium policy is first paid by the insured, it is wholly "unearned," in the sense that the entire premium is attributable to the unexpired portion of the policy. As the term of the policy expires with the passage of time, a pro-

portionate part of the premium becomes "earned"; *i.e.*, attributable to insurance protection provided during the expired portion of the policy.

26. The allocable amount of premiums remaining unearned on the insurer's statement date is usually computed on either a pro rata basis or under the "sum-of-the-digits" method, the latter method being referred to in the insurance industry as the "Rule of 78."[1] For example, an insurance company that received a $300 premium at the inception of a three-year single premium accident and health policy would have an unearned premium reserve at the end of the first year of $200 ($2/3 \times \$300$) computed on a pro rata basis, or an unearned premium reserve of $150.

$$\left(\frac{3}{(3+2+1)} \times \$300\right)$$

computed under the Rule of 78. The unearned premium reserves maintained by Old Republic, Pilot and National Fidelity on credit accident and health insurance covering debtors of Aetna and its subsidiaries, and unearned premium reserves maintained by Plaintiff under its reinsurance treaty with Insurance City, were determined under the Rule of 78.

27. Several methods can be used to arrive at a value for the unearned premium reserve where many policies are outstanding at the statement date. The most precise would be to determine the exact date of issuance of each outstanding policy so that the unexpired portion of each policy in force at the statement date can be ascertained. However, the cost and time involved in making such a computation is prohibitive to companies without sophisticated data processing

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[1] Under the Rule of 78, the unearned premium is determined by applying changing fractions to the premium paid by the insured. The numerator of the fraction changes each year to a number which corresponds to the remaining unexpired term of the policy, and the denominator which remains constant is the sum of all the years' digits corresponding to the entire term of insurance coverage. Where the unearned premium is determined on a monthly rather than a yearly basis, the numerator will correspond to the number of months in the term which remain unexpired and the denominator will be the sum of all the months' digits corresponding to the entire term.

equipment. Therefore, assumptions are commonly made as to the dates on which outstanding policies were issued.

The unearned premium reserves maintained by Old Republic, Pilot, and National Fidelity on credit accident and health insurance covering debtors of Aetna and its subsidiaries, as well as the unearned premium reserves maintained by Plaintiff under its reinsurance treaty with Insurance City, were computed monthly on the assumption that all policies issued during a particular month were issued at the end of the month. For example, if Old Republic received $100,000 in accident and health premiums during the month of December with respect to the issuance of credit life, accident and health policies to Aetna loan customers, its unearned premium reserves were computed on the assumption that all of such policies were issued on December 31 and that the $100,000 in premiums were likewise received on December 31. The Internal Revenue Service has recomputed such unearned premium reserves maintained by Old Republic, Pilot, National Fidelity and Plaintiff at December 31, 1962, 1963, 1964 and 1965, using an assumption that all policies issued during a given month were issued on the 15th day rather than the last day of such month. Plaintiff does not contest such adjustments.

28. The life insurance reserves set aside by Plaintiff during the years in issue were computed by the firm of Nelson and Warren, Inc., independent actuarial consultants, in accordance with the terms of the outstanding reinsured policies and the laws of the State of Missouri based on the Commissioners' 1941 Standard Ordinary Mortality Table and an assumed rate of interest of two percent. The Commissioners' 1941 Standard Ordinary Mortality Table is a recognized mortality table, approved by the National Association of Insurance Commissioners.

29. With respect to all life insurance reserves established and reported by Plaintiff on its Annual Statements, the company which issued the policies in each instance was given credit, as reinsurance ceded, by the insurance authorities of the states in which such companies did business, for the life insurance reserves so established and reported by Plaintiff, to the extent of such State's reserve requirements.

30. For each of the years 1962, 1963, 1964 and 1965, Plaintiff filed an Annual Statement on the form prescribed by the National Association of Insurance Commissioners for life and accident and health companies. The data and statements contained in these Annual Statements were taken from and accurately reflected Plaintiff's books and records. True and correct copies of the Annual Statements filed by Plaintiff for the years 1962, 1963, 1964 and 1965 are attached hereto and marked Exhibits 17 to 20, respectively.

31. Plaintiff did not reflect on its Annual Statements submitted to the Missouri Division of Insurance any unearned premium reserves during 1962, 1963, 1964 or 1965 with respect to credit accident and health insurance issued by Old Republic, Pilot or National Fidelity. Unearned premium reserves on credit accident and health insurance issued by Old Republic, Pilot and National Fidelity covering debtors or Aetna and its subsidiaries were reflected in the Annual Statements filed by Old Republic, Pilot and National Fidelity for the years 1962, 1963, 1964 and 1965 with the insurance authorities of the various states in which they did business. The Annual Statements of those companies were accepted by such authorities in all such states.

32. The only unearned premium reserves reflected on Plaintiff's Annual Statements submitted to the Missouri Division of Insurance for the years 1962, 1963, 1964 and 1965 were those relating to Plaintiff's reinsurance treaty with Insurance City, which were reflected on a gross unearned premium basis.

33. True and correct copies of reports of examination of Plaintiff as of December 31, 1964 and 1968 are attached hereto as Exhibits 24 and 25.

34. Unpaid losses represent the measure of an insurance company's liability to make future payments with respect to claims that have already been incurred as of the statement date. A provision for unpaid losses is needed to cover claims that commenced in the past and under which benefits are still being paid or are to be paid as soon as proof of loss has been provided to the insurer.

35. The Annual Statements filed by Plaintiff with the Missouri Division of Insurance for the years 1962, 1963, 1964 and 1965 reflected unpaid losses with respect to credit accident and health insurance issued by Pilot, National Fide-

lity, Insurance City and American Bankers and reinsured by Plaintiff, and the company which issued the policies in each instance was given credit by the insurance authorities of the states in which such companies did business for unpaid losses reported by Plaintiff. Unpaid losses with respect to credit accident and health insurance issued by Old Republic were reflected on the Annual Statements filed by Old Republic.

36. Some accident and health policies are written for the life of the insured at a guaranteed annual premium. A reserve in addition to the unearned premium reserve must be maintained on such policies as a consequence of charging a premium for a benefit that costs increasingly more to provide as the insured grows older. This additional reserve is accumulated from premium payments and interest earnings that will not be needed to pay claims arising during the current policy year of the contract. The reserve is computed on the basis of recognized morbidity tables at an assumed rate of interest. An additional reserve is also required where the policy is written for some term which is shorter than the insured's life where the premium charged provides a benefit that costs increasingly more to provide as the insured grows older. Neither Old Republic, Pilot, nor National Fidelity maintained an additional reserve in addition to the unearned premium reserve with respect to credit accident and health insurance covering debtors of Aetna and its subsidiaries.

37. Old Republic, Pilot and National Fidelity reflected on their books and Annual Statements unearned gross premium reserves on all credit accident and health insurance reinsured with Plaintiff.

38. Old Republic, Pilot and National Fidelity used and had custody of unearned premiums received for credit accident and health insurance covering debtors of Aetna and its subsidiaries. Such unearned premiums were maintained by Old Republic, Pilot and National Fidelity along with their other reserve funds in accordance with the applicable restrictions of state law, and they received the proceeds of such investments (interests, dividends, etc.) as their own income. Plaintiff did not obtain or use the unearned premiums held by Old Republic, Pilot and National Fidelity before they were payable as reinsurance premimus under the

terms of the respective reinsurance treaties nor were such unearned premiums credited, set apart or made available to Plaintiff.

39. [Deleted]

40. The insurance business is regulated by the states. For example, the state insurance departments supervise policy forms, agency relationships, investments, accounting practices, reserves, and the general financial responsibility of insurance companies. State law and/or regulations directing insurance companies to set up reserves are designed to preserve the solvency of those companies for the protection of policyholders.

41. By 1967, Plaintiff's volume of business had increased to the point at which it was more profitable for Plaintiff to write its own credit insurance policies than to reinsure other companies issuing policies to debtors of Aetna and its subsidiaries.

42. None of the reinsurance treaties in force during the years in issue has even been canceled. When Plaintiff qualified to do business in a state, it notified the company it had been reinsuring that, after a certain date, it would be issuing its own credit insurance policies to loan customers of Aetna in that particular state and that the policies of the former direct insurer would be no longer used. In every case, however, Plaintiff continued to reinsure policies previously issued by the direct insurer (and, in the case of reinsured credit accident and health insurance, the direct insurer continued to pay the reinsurance premiums called for under the terms of the treaty) until all policies that had been reinsured under the treaty had either been terminated, canceled or had expired.

43. Plaintiff today writes a complete portfolio of the standard forms of ordinary and term insurance contracts, including individual and group life, accident and health, and surgical coverage, as well as credit insurance for borrowers and installment purchasers.

44. On December 22, 1965, Plaintiff issued Group Annuity Contract No. 101 to the St. Louis Union Trust Company, as Trustee of Pension Fund No. 6 of the International Telephone Retirement Plan for Salaried Employees, effective as of December 1, 1965. Prior to this transaction, no group

annuity or individual annuity contracts had been purchased by IT&T. The St. Louis Union Trust Company, or any Trustee of any pension fund of the International Telephone Retirement Plan for Salaried Employees from any insurance company or other person on the lives of the individuals covered under Group Annuity Contract No. 101. Group Annuity Contract No. 101 was issued solely by and in the name of Plaintiff, and has remained outstanding and in effect to the present time.

45. A true and correct copy of the International Telephone Retirement Plan for Salaried Employees as amended to July 1, 1966, is attached hereto as Exhibit 21. The terms of the Plan in effect on December 1, 1965, were substantially the same in all relevant respects as the terms contained in Exhibit 21. A true and correct copy of a Trust Agreement between IT&T and the St. Louis Union Trust Company pursuant to ITT's International Telephone Retirement Plan for Salaried Employees, dated as of December 15, 1965, is attached hereto as Exhibit 22. A true and correct copy of Group Annuity Contract No. 101 issued by Plaintiff to the St. Louis Union Trust Company as Trustee of Pension Fund No. 6 of the International Telephone Retirement Plan for Salaried Employees, as amended, is attached hereto as Exhibit 23.

46. On or about December 22, 1965, Plaintiff received securities valued at $5,929,057.24 from the St. Louis Union Trust Company for the purchase of single premium annuities for certain retired individuals covered by the International Telephone Retirement Plan for Salaried Employees. The receipt of such premiums obligated Plaintiff to pay annuities to such retired individuals (and their spouses, in some cases) under the terms of Group Annuity Contract No. 101.

47. Plaintiff maintained a reserve of $6,072,004.00 on December 31, 1965, with respect to its liabilities under Group Annuity Contract No. 101 on that date. Such reserve was computed on the basis of a recognized mortality table (1951 G.A.) and an assumed rate of interest (3½%), and was set aside to mature or liquidate future unaccrued claims arising under Group Annuity Contract No. 101.

48. For each of the years 1963, 1964 and 1965, Plaintiff timely filed with the District Director of Internal Revenue at St. Louis a Federal income tax return on Treasury Form

1120L, U.S. Life Insurance Company tax return, and computed its taxable income and tax as a life insurance company according to section 802 of the Code. The tax shown to be due on the returns filed for those years, as reported in the table below, was paid in full.

Year:	*Tax Shown To Be Due On Plaintiff's Return*
1963	$479,356.02
1964	377,217.70
1965	467,266.14

49. On August 18, 1967, Plaintiff filed with the District Director of Internal Revenue at St. Louis, Missouri, claims for refund of income taxes previously paid in respect of the years 1963, 1964 and 1965 (hereafter referred to as the 1967 claims) in the following amounts:

Year:	*Amount Claimed*
1963	$156,148.50 (or in the alternative $143,737.56).
1964	$140,482.78.
1965	$47,252.76.

50. Neither the Secretary of Treasury or his delegate having theretofore rendered a decision on said 1967 claims, Plaintiff on April 4, 1968, filed suit for a refund of such income taxes in this Court.

51. On October 24, 1968, after Plaintiff had filed a petition claiming a refund of income taxes paid in respect of the years 1963, 1964 and 1965 in this Court, and prior to a hearing of Plaintiff's claims, the Commissioner of Internal Revenue determined deficiencies in Plaintiff's income tax for the years 1963, 1964 and 1965, in the following amounts:

Year:	*Deficiency*
1963	$337,376.70
1964	362,986.20
1965	265,412.05

The asserted deficiencies were based upon a determination that Plaintiff did not qualify as a life insurance company during the years 1963, 1964 and 1965 under section 801(a) of the Code, but rather was taxable as an insurance company other than a life or mutual insurance company in those years.

52. Plaintiff did not file a petition with the Tax Court for a redetermination of the asserted deficiency within the time allowed by section 6213(a) of the Code, or at any

time thereafter. On February 14, 1969, the Commissioner of Internal Revenue assessed the amount of the asserted deficencies in Plaintiff's income tax for the years 1963, 1964 and 1965, together with interest on such deficiencies, and demanded payment thereof. Plaintiff contests the validity of this assessment. On March 5, 1969, the following amounts were paid to the District Director of Internal Revenue at St. Louis, Missouri, under protest, in respect of the deficiencies in Plaintiff's income taxes assessed for the years 1963, 1964 and 1965, and interest thereon:

Year	Deficiency	Interest	Total
1963	$337,376.70	$99,747.96	$437,124.66
1964	362,986.20	85,540.43	448,526.63
1965	265,412.05	46,621.63	312,033.26

53. On April 21, 1969, Plaintiff filed with the District Director of Internal Revenue at St. Louis, Missouri, claims for refund of the amounts assessed by the Commissioner of Internal Revenue on February 14, 1969, and paid by Plaintiff on March 5, 1969, as additional income taxes, and interest thereon, for the years 1963, 1964 and 1965 (hereafter referred to as the 1969 claims). Plaintiff received a formal notice of disallowance of its 1969 claims from said District Director on December 3, 1969, and filed its First Amended Petition with this Court on March 30, 1970, seeking recovery of income taxes with respect to both its 1969 and 1967 claims.

54. On May 8, 1969, Defendant filed a motion with this Court for leave to file an amended answer to Plaintiff's petition. The purpose of the amended answer was to add a counterclaim to defendant's answer. Defendant's motion was allowed and an amended answer was filed on July 8, 1969, which amended answer included a counterclaim for the amounts assessed by the Commissioner of Internal Revenue on February 14, 1969, as additional income taxes and interest for the years 1963, 1964 and 1965. Plaintiff filed a reply to Defendant's counterclaim on August 12, 1969, alleging, *inter alia*, full payment of such additional taxes and interest.

55. The amounts of life insurance reserves, unearned premium reserves, and unpaid losses at the end of each of the years 1962, 1963, 1964 and 1965, as reported by Plaintiff on its tax returns and as adjusted by Defendant, are set forth in the following schedule:

ITT Hamilton Life Insurance Company.—Insurance Reserves at December 31, 1962, per Tax Returns and as Adjusted by Commissioner of Internal Revenue.

	12/31/62		
	Per Return	IRS Adjustments	Per Notice of Deficiency
I. Life Insurance Reserves:			
1. Credit Life Insurance	$556, 923. 00	----------	$556, 923. 00
2. Annuity Reserves			
Total Life Insurance Reserves	556, 923. 00	----------	556, 923. 00
II. Total Reserves:			
1. Life Insurance Reserves	556, 923. 00	----------	556, 923. 00
2. Unpaid Losses on Credit Life	91, 706. 40	$5, 245. 48	96, 951. 88
3. Unearned Premiums on Credit A&H	22, 631. 66	1, 326, 635. 36	1, 349, 267. 02
4. Unpaid Losses on Credit A&H	118, 847. 01	(17, 979. 96)	100, 867. 05
Total Reserves	790, 108. 07	1, 313, 900. 88	2, 104, 008. 95

ITT Hamilton Life Insurance Company.—Insurance Reserves at December 31, 1963, per Tax Returns and as Adjusted by Commissioner of Internal Revenue.

	12/31/63		
	Per Return	IRS Adjustments	Per Notice of Deficiency
I. Life Insurance Reserves:			
1. Credit Life Insurance	$733,027.00	($70,241.77)	$662,785.23
2. Annuity Reserves			
Total Life Insurance Reserves	733,027.00	70,241.77	662,785.23
II. Total Reserves:			
1. Life Insurance Reserves	733,027.00	(70,241.77)	662,785.23
2. Unpaid Losses on Credit Life	126,487.73	6,108.70	132,596.43
3. Unearned Premiums on Credit A&H	37,787.68	1,412,430.88	1,450,218.56
4. Unpaid Losses on Credit A&H	195,616.08	(64,384.15)	131,231.93
Total Reserves	1,092,918.49	1,283,913.66	2,376,832.15

ITT Hamilton Life Insurance Company—Insurance Reserves at December 31, 1964, per Tax Returns and as Adjusted by Commissioner of Internal Revenue

	12/31/64		
	Per Return	IRS Adjustments	Per Notice of Deficiency
I. Life Insurance Reserves:			
1. Credit Life Insurance	$806, 698. 00	($58, 076. 72)	$748, 621. 28
2. Annuity Reserves			
Total Life Insurance Reserves	806, 698. 00	(58, 076. 72)	748, 621. 28
II. Total Reserves			
1. Life Insurance Reserves	806, 698. 00	(58, 076. 72)	748, 621. 28
2. Unpaid Losses on Credit Life	309, 061. 73	(7, 491. 63)	301, 570. 10
3. Unearned Premiums on Credit A&H	59, 673. 48	1, 414, 955. 66	1, 474, 629. 14
4. Unpaid Losses on Credit A&H	557, 692. 76	14, 652. 24	572, 345. 00
Total Reserves	1, 733, 125. 97	1, 364, 039. 55	3, 097, 165. 52

ITT Hamilton Life Insurance Company— Insurance Reserves at December 31, 1965, per Tax Returns and as Adjusted by Commissioner of Internal Revenue

	12/31/65		
	Per Return	IRS Adjustments	Per Notice of Deficiency
I. Life Insurance Reserves:			
1. Credit Life Insurance	$965, 229. 00	($63, 226. 31)	$902, 002. 69
2. Annuity Reserves	6, 072, 004. 00	(5, 633, 073. 88)	502, 156. 43
Total Life Insurance Reserves	7, 037, 233. 00	(5, 633, 073. 88)	1, 404, 159. 12
II. Total Reserves:			
1. Life Insurence Reserves	7, 037, 233. 00	(5, 633, 073. 88)	1, 404, 159. 12
2. Unpaid Losses on Credit Life	94, 770. 07	(4, 888. 17)	89, 881. 90
3. Unearned Premiums on Credit A&H	92, 353. 42	1, 738, 805. 49	1, 831, 158. 91
4. Unpaid Losses on Credit A&H	188, 752. 09	(85, 356. 54)	103, 395. 55
Total Reserves	7, 413, 108. 58	(3, 984, 513. 10)	3, 428, 595. 48

56. The amounts of the unearned gross premium reserves maintained by Plaintiff as of December 31, 1962, 1963, 1964 and 1965, and the amounts of the unearned gross premium reserves that Defendant contends are attributable to Plaintiff as of December 31, 1962, 1963, 1964 and 1965, both as adjusted by the Internal Revenue Service as described in paragraph 27 for the purpose of this case, are as follows:

	12/31/62	12/31/63	12/31/64	12/31/65
Plaintiff	$22,631.66	$24,829.73	$34,277.89	$36,593.35
Old Republic	183,841.66	147,374.59	145,823.08	191,415.66
Pilot	728,821.16	782,726.13	724,444.86	829,480.16
National Fidelity	413,972.54	495,288.11	570,083.34	773,669.74
Total	1,349,267.02	1,450,218.56	1,474,629.14	1,831,158.91

57. The adjustments to Plaintiff's unearned premium reserves made by the Internal Revenue Service in determining whether Plaintiff qualified as a life insurance company in the years in issue were calculated on a gross unearned premium basis. Plaintiff contends that the entire amount of such adjustments is improper, but in the alternative contends that unearned premium reserves, particularly those arising from such adjustments, should have been computed on a net premium basis. If the Court sustains Plaintiff's alternative contentions in this regard, and further holds, contrary to Defendant's contention, that Plaintiff's unpaid losses on credit life insurance are includable in the numerator of the life insurance company qualification formula, then Plaintiff will qualify as a life insurance company for each of its taxable years ending December 31, 1963, 1964 and 1965.

The following "tabular morbidity reserves" represent the total "net premium" (*i.e.*, morbidity) element in the unearned gross premium reserves reflected on the Annual Statements of Old Republic, Pilot, National Fidelity and Plaintiff (under the Insurance City reinsurance treaty) on December 31, 1962, 1963, 1964 and 1965, respectively, with

respect to credit accident and health insurance policies issued to loan customers of Aetna and its subsidiaries:

Date:	*Total Tabular Morbidity Reserve*
December 31, 1962	$434,213
December 31, 1963	503,279
December 31, 1964	559,401
December 31, 1965	652,489

The above "tabular morbidity reserves" were computed on the basis of the 1964 Commissioners' Disability Table, a recognized morbidity table approved by the National Association of Insurance Commissioners.

58. The percentage of Plaintiff's "life insurance reserves" to its total reserves (as defined in section 801 of the Internal Revenue Code of 1954) as computed by the Plaintiff on its income tax returns for the years 1963, 1964 and 1965, and as computed by the Defendant on the basis of its adjustments to Plaintiff's reserves were as follows:

	1963, Per Plaintiff's Return		
	1/1/63	12/31/63	Mean
1. Life Insurance Reserves	$556,923.00	$733,027.00	$644,975.00
2. Total Reserves	790,108.07	1,092,918.49	941,513.28
3. Reserve Test Ratio (1÷2)			68.50%
	1963, Per Defendant's Adjustments		
1. Life Insurance Reserves	$556,923.00	$662,785.23	$609,854.12
2. Total Reserves	2,104,008.95	2,376,832.15	2,240,420.55
3. Reserve Test Ratio (1÷2)			27.2%
	1964, Per Plaintiff's Return		
	1/1/64	12/31/64	Mean
1. Life Insurance Reserves	$733,027.00	$806,698.00	$769,862.50
2. Total Reserves	1,092,918.49	1,733,125.97	1,413,022.23
3. Reserve Test Ratio (1÷2)			54.48%

	1964, Per Defendant's Adjustments		
	1/1/64	12/31/64	Mean
1. Life Insurance Reserves	$662, 785. 23	$748, 621. 28	$705, 703. 26
2. Total Reserves	2, 376, 832. 15	3, 097, 165. 52	2, 736, 998. 84
3. Reserve Test Ratio (1÷2)			25. 8%

	1965, Per Plaintiff's Return		
	1/1/65	12/31/65	Mean
1. Life Insurance Reserves	$806, 698. 00	$7, 037, 233. 00	$3, 921, 965. 50
2. Total Reserves	1, 733, 125. 97	7, 413, 108. 58	4, 573, 117. 28
3. Reserve Test Ratio (1÷2)			85. 76%

	1965, Per Defendant's Adjustments		
1. Life Insurance Reserves	$748, 621. 28	$1, 404, 159. 12	$1, 076, 390. 20
2. Total Reserves	3, 097, 165. 52	3, 428, 595. 48	3, 262, 880. 50
3. Reserve Test Ratio (1÷2)			32. 99%

58.59. Added by amendment.

Respectfully submitted,

(S) Owen T. Armstrong,
OWEN T. ARMSTRONG,
Attorney for Plaintiff.

(S) Johnnie M. Walters (PRM)
JOHNNEI M. WALTERS,
Assistant Attorney General.

_____,
Attorney for Defendant.

EXHIBIT 1

LIFE REINSURANCE TREATY

THIS AGREEMENT between OLD REPUBLIC LIFE INSURANCE COMPANY, Clayton, Missouri (herein called "Old Republic") and AMERICAN UNIVERSAL LIFE INSURANCE COMPANF, Clayton, Missouri (herein called "American"),

WITNESSETH:

ARTICLE I

Old Republic hereby agrees to cede to American and American agrees to accept as reinsurance Old Republic's entire liability under all life insurances (herein called "said insurance") written by Old Republic on or after January 1, 1961 under its Account No. 1551, which insures the lives of certain debtors of Aetna Finance Company and its subsidiaries.

ARTICLE II

Old Republic shall pay to American in the manner hereinafter provided, a reinsurance premium equal to ninety one and one quarter percent (91¼%) of the net premium received on said insurances. Net premium, as used in this treaty, shall be gross premium less returns on account of cancellation. Old Republic shall pay all agents' and brokers' commissions and taxes imposed by states on the issuance of said insurances.

ARTICLE III

On the 25th day of February, 1961, and of each month thereafter, Old Republic shall submit to American a statement covering the preceding month and showing the following information with respect to said insurances:

A. Premiums written minus premiums returned to insured persons or policyholders;

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B. Losses incurred (losses and allocated loss expense paid under said insurances during the preceding month, plus loss reserves on said insurances at the end of said month, loss reserves at the beginning of said month);

C. The number of said policies and amount of insurance:

(a) Issued during the preceding month;

(b) Surrendered for cancellation during the preceding month;

(c) Terminated by death during the preceding month;

(d) Expired during the preceding month;

(e) In force at the end of the preceding month.

D. Reinsurance premium;

E. Such other details as may reasonably be requested by American.

Against payment of the reinsurance premium, Old Republic shall be entitled to set off amounts due from American to Old Republic on account of losses and loss expenses paid during said month.

If the reinsurance premium payable exceeds the losses incurred, the excess shall be paid by Old Republic to American at the time said statement is rendered. If the losses incurred exceed the reinsurance premium, the excess shall be paid by American to Old Republic within ten (10) days after receipt of said statement.

ARTICLE IV

Old Republic furnishes American herewith specimen forms upon which all said insurances are written, and will promptly notify American of all changes in said forms. The supervision of all claims under said insurances shall be handled by Old Republic. The liability of American shall follow the liability of Old Republic in accordance with the terms and conditions of said insurances.

ARTICLE V

In the event of the insolvency of Old Republic, the reinsurance under this treaty shall be payable by American on the basis of the claim or claims allowed against the insolvent Old Republic by any court of competent jurisdiction or any justice or judge thereof, or by any receiver or liquidator having authority to determine and allow such claims. It is agreed, however, that the liquidator, receiver or statutory

successor of Old Republic will be required to give written notice to American of the pendency of a claim against Old Republic on the policy reinsured within a reasonable time after such claim is filed, and that during the pendency period of such claim, American may investigate such claim and interpose, at its own expense, in the proceeding where such claim is to be adjudicated, any defense or defenses which it may deem available to Old Republic or its liquidator or receiver or statutory successor. The expense thus incurred by American shall be chargeable, subject to court approval, against Old Republic as part of the expense of liquidation to the extent of a proportionate share of the benefit which may accrue to Old Republic solely as a result of the defense undertaken by American.

ARTICLE VI

In the event of the insolvency, bankruptcy, rehabilitation, receivership or liquidation of American, Old Republic may retain all or any portion of any amount due under this treaty for the purpose of paying any and all losses of policyholders and expenses pertaining thereto which arise or may arise under the insurances reinsured under this treaty. When all losses have been paid, Old Republic shall pay to American the full amount of any balance of the reinsurance premium then remaining.

ARTICLE VII

A. This treaty may, by mutual consent, be altered in any of its terms and conditions by a signed addendum thereto.

B. This treaty may be terminated by either party upon sixty (60) days' written notice to the other party given at any time.

C. Upon termination by either party, this treaty shall continue to apply to all said insurances issued before the date such termination becomes effective and until such insurances expire or are otherwise validly terminated.

ARTICLE VIII

This treaty may be executed in any number of counterparts and all executed counterparts shall be originals.

214-447—76——5

IN WITNESS WHEREOF, the parties hereto have caused this instrument to be duly executed and sealed by their respective corporate seals on this — day of ————, 1961.

OLD REPUBLIC LIFE INSURANCE COMPANY,
By: CHARLES S. WILKES.

Attest:
———— ————, *Secretary.*

AMERICAN UNIVERSAL LIFE INSURANCE COMPANY,
By ———— ————.

Attest:
———— ————, *Secretary.*

ADDENDUM NO. 1 TO REINSURANCE TREATY NO. 6

This Addendum attached to and made a part of a Reinsurance Treaty entered into by OLD REPUBLIC LIFE INSURANCE COMPANY, Chicago, Illinois (therein called "Old Republic" and American Universal Life Insurance Co., Clayton, Missouri, (therein caled "American Universal") on the 23rd of March, 1961.

Witnesseth:

It is hereby agreed between the parties hereto that Article V of the said Reinsurance Treaty is deleted and the following substituted therefor:

"ARTICLE V

In the event of the insolvency of Old Republic, the insurance under this treaty shall be payable without diminution because of Old Republic's insolvency by American Universal to Old Republic's liquidator, receiver or statutory successor on the basis of the claim or claims allowed on said insurances against the insolvent Old Republic by any court of competent jurisdiction or any justice or judge thereof, or by any receiver, liquidator or statutory successor having authority to determine and allow such claims.

It is agreed, however, that the liquidator, receiver or statutory successor of Old Republic shall have to give written notice to American Universal of the pending of a claim against Old Republic on this treaty within a reasonable time after such claim is filed in the insolvency proceeding and that during the pendency of such claim, American Universal may investigate such claim and interpose, at its own expense, in the proceeding where such claim is to be adjudicated any defense or defenses which it may deem available to Old Republic or its liquidator, receiver or statutory successor. The expense thus incurred by American Universal shall be chargeable subject to court approval, against Old Republic as a part of the expense of liquidation to the extent of a proportionate share of the benefits which may accrue to Old Republic solely as a result of the defense undertaken by American Universal."

This Addendum is effective retroactively to the first day of May 1963.

IN WITNESS WHEREOF, the parties have signed this addendum the 7th day of February, 1964.

OLD REPUBLIC LIFE INSURANCE COMPANY,
By CHARLES S. WILKES.
AMERICAN UNIVERSAL LIFE INS. CO.,
By JOSEPH KUTTEN, *President.*

AMENDMENT

TO

LIFE REINSURANCE TREATY No. 6

This Amendment attached to and made a part of a certain Life Reinsurance Treaty No. 6, effective January 1, 1961, between AMERICAN UNIVERSAL LIFE INSURANCE COMPANY, Clayton, Missouri (therein called "American") and OLD REPUBLIC LIFE INSURANCE COMPANY, Chicago, Illinois (therein called "Old Republic"),

Witnesseth:

Old Republic and American hereby agree that the aforesaid Treaty is hereby amended from its inception by the addition of Article IX to read as follows:

> "American will maintain such reserves on this reinsurance as may lawfully be required by regulatory authorities having jurisdiction over American."

All other terms and conditions of said Life Reinsurance Treaty No. 6 remain unchanged and in full force and effect.

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be executed by their duly authorized officers and their corporate seals affixed this 23rd day of January, 1962.

AMERICAN UNIVERSAL LIFE INSURANCE COMPANY,
By JOSEPH KUTTEN, *Pres.*

Attest:
_____ _____ *Secretary.*

OLD REPUBLIC LIFE INSURANCE COMPANY,
By _____ _____
Vice President.

Attest:
_____ _____ *Secretary.*

EXHIBIT 2

DISABILITY REINSURANCE TREATY

THIS AGREEMENT between OLD REPUBLIC LIFE INSURANCE COMPANY, Chicago, Illinois (herein called "Old Republic") and AMERICAN UNIVERSAL LIFE INSURANCE COMPANY, Clayton, Missouri (herein called "American"),

Witnesseth:

ARTICLE I

A. Old Republic hereby agrees to cede to American and American agrees to accept as reinsurance Old Republic's entire liability under all disability insurances written in combination with life insurance all accident and health insurances

(herein collectively called "said insurances") written by Old Republic on or after January 1, 1961 under its Account No. 1551, which insurances provide coverage for certain debtors of Aetna Finance Company and its subsidiaries.

B. This treaty shall run for a period of one month from the effective date hereof and shall be automatically renewed from month to month until terminated as hereinafter provided.

ARTICLE II

Old Republic shall pay to American in the manner hereinafter provided, a reinsurance premium equal to eighty-nine percent (89%) of the total premiums earned on the said insurances during each month as defined in Article III of this treaty. Old Republic shall pay all agents' and brokers' commissions and taxes imposed by states on the issuance of said insurances.

ARTICLE III

On the 25th day of February, 1961, and each month thereafter, Old Republic shall submit to American a statement covering the preceding month and showing the following information:

A. Earned premiums (premiums written less return premiums plus unearned premium reserves at the beginning of said month less unearned premium reserves at the end of said month, the unearned premium reserves being computed on a monthly pro rata basis);

B. Losses paid, which term includes allocated loss expense. Allocated loss expense shall include all expenses incurred by Old Republic in the investigation, adjustment, litigation and defense of claims including court costs and interest accrued after judgment, but excluding any office expense of Old Republic employees;

C. Loss reserves, including those for incurred but unreported losses, and allocated loss expenses, as of the beginning of the month;

D. Loss reserves, including those for incurred but unreported losses, and allocated loss expenses, as of the end of the month;

E. Amount of accident and health insurance in force at the end of the month;

F. Reinsurance premium.

If the sum of Items B and D is less than the sum of Items C and F shown on said statement, the difference shall be paid by Old Republic to American at the time such statement is delivered. If the sum of Items B and D is more than the sum of Items C and F, the excess is to be paid by American to Old Republic within ten (10) days after the receipt of such statement.

Old Republic shall furnish such details with respect to said monthly statements as may reasonably be requested by American, and American shall have at all times full and free access, during business hours at the home office of Old Republic, to all books, records and files of Old Republic relating to the business covered by this treaty.

ARTICLE IV

Old Republic furnishes American herewith specimen forms upon which all said insurances are written, and will promptly notify American of all changes in said forms. Supervision of all claims under said insurances shall be handled by Old Republic. The liability of American shall follow the liability of Old Republic in accordance with the terms and conditions of said insurances.

ARTICLE V

In the event of the insolvency of Old Republic, the reinsurance under this treaty shall be payable by American on the basis of the claim or claims allowed against the insolvent Old Republic by any court of competent jurisdiction or any justice or judge thereof, or by any receiver or liquidator having authority to determine and allow such claims. It is agreed, however, that the liquidator, receiver or statutory successor of Old Republic will be required to give written notice to American of the pendency of a claim against Old Republic on the policy reinsured within a reasonable time after such claim is filed, and that during the pendency period of such claim, American may investigate such claim and interpose, at its own expense, in the proceeding where such claim is to be adjudicated, any defense or defenses which it may deem available to Old Republic or its liquidator or receiver or statutory successor. The expense thus incurred by American shall be chargeable, subject to

court approval, against Old Republic as part of the expense of liquidation to the extent of a proportionate share of the benefit which may accrue to Old Republic solely as a result of the defense undertaken by American.

ARTICLE VI

In the event of the insolvency, bankruptcy, rehabilitation, receivership or liquidation of American, Old Republic may retain all or any portion of any amount due under this treaty for the purpose of paying any and all losses of policyholders and expenses pertaining thereto which arise or may arise under the insurances reinsured under this treaty. When all losses have been paid, Old Republic shall pay to American the full amount of any balance of the reinsurance premium then remaining.

ARTICLE VII

A. This treaty may, by mutual consent, be altered in any of its terms and conditions by a signed addendum thereto.

B. This treaty may be terminated by either party effective on the last day of any renewal period upon thirty (30) days' written notice to the other party, in which event American, by written notice given to Old Republic at any time prior to the effective date of such termination, may elect to continue this agreement from month to month but only as respects said insurances issued by Old Republic before the effective date of termination; provided that American at its option and upon at least thirty (30) days' written notice may terminate this agreement on the last day of any month as to all such insurances on which American had previously elected to continue on a month-to-month basis. It is understood that any liability of American arising under its reinsurances of said policies under such election is on a month-to-month basis only and is limited solely to such excess amount as shall become payable under Article III of this agreement by American to Old Republic in any month during which American elects that this agreement may continue.

ARTICLE VIII

This treaty may be executed in any number of counterparts and all executed counterparts shall be originals.

IN WITNESS WHEREOF, the parties hereto have caused this instrument to be duly executed and sealed by their respective corporate seals on this ——— day of ———, 1961.

OLD REPUBLIC LIFE INSURANCE COMPANY,
By CHARLES S. WILKES.

Attest:

———— ————, *Secretary.*

AMERICAN UNIVERSAL LIFE INSURANCE COMPANY,

By ———— ————.

Attest:

———— ————, *Secretary.*

AMERICAN UNIVERSAL LIFE INSURANCE COMPANY,
Clayton 5, Mo., April 11, 1961.

Mr. G. W. KRAMER,
Vice President, Old Republic Life Insurance Company,
307 North Michigan Avenue,
Chicago, Illinois.

DEAR BILL: Reference is made to the Disability Reinsurance Treaty executed between our Companies on March 23, 1961, effective January 1, 1961.

This letter is intended as a modification of said Treaty and a clarification of the manner of transmittal of reinsurance premiums.

Sub paragraph A of Article III states ". . . the unearned premium reserves being computed on a monthly pro rata basis." It is my definite understanding that this computation will be made solely on the rule of the sum-of-the-digits (Rule of "78").

The procedure to be followed in making remittances under this Treaty will be as follows:

(1) All computations of the unearned premium on the Rule of 78 will be made by American Universal. This computation will be made as of the close of each calendar quarter

in the form of a summary of machine tabulated run. In addition thereto a detailed tabular run will be furnished your Company by American Universal shortly after December 31st of each year.

(2) It will not be necessary for your Company to make any remittances of the reinsurance premium under this Treaty until it receives a summary of the machine tabular run as of September 30, 1961.

(3) If the net premiums written under this Treaty are less than the unearned premiums under the summary of the machine tabular run then no remittance need be made until your Company receives the summary of the machine tabular run as of December 31, 1961.

(4) If the total of the net A & H premiums written under this Treaty up to and including September 30th are greater than the summary of the machine tabular run as of September 30, 1961 the difference shall be remitted forthwith by your Company to American Universal as the reinsurance premium on said business.

(5) Thereafter we shall arbitrarily consider the written net premiums on disability insurance each month to be the same as the earned premium for that month. Any fluctuations in the unearned premium reserve determined by the summary of the machine tabulated run shall be adjusted either upward or downward in the remittance of the earned reinsurance premium for the following month.

Please return the original to this letter.

Respectfully yours,

AMERICAN UNIVERSAL LIFE INSURANCE COMPANY,

By JOSEPH KUTTEN, *President.*

CHICAGO, ILLINOIS.

This, 20 day of April, 1961.

To: American Universal Life Insurance Company

GENTLEMEN: The contents of this letter are acceptable to our Company.

CHARLES S. WILKES,
Administrative Vice President.

ADDENDUM No. 2 TO REINSURANCE TREATY No. 7

This Addendum attached to and made a part of a Reinsurance Treaty entered into by OLD REPUBLIC LIFE INSURANCE COMPANY, Chicago, Illinois (therein called "Old Republic" and American Universal Life Insurance Co., Clayton, Missouri, (therein called "American Universal") on the 23rd day of March, 1961.

Witnesseth:

It is hereby agreed between the parties hereto that Article V of the said Reinsurance Treaty is deleted and the following substituted therefor:

"ARTICLE V

In the event of the insolvency of Old Republic, the insurances under this treaty shall be payable without diminution because of Old Republic's insolvency by American Universal to Old Republic's liquidator, receiver or statutory successor on the basis of the claim or claims allowed on said insurances against the insolvent Old Republic by any court of competent jurisdiction or any justice or judge thereof, or by any receiver, liquidator or statutory successor having authority to determine and allow such claims. It is agreed, however, that the liquidator, receiver or statutory successor of Old Republic shall have to give written notice to American Universal of the pending of a claim against Old Republic on this treaty within reasonable time after such claim is filed in the insolvency proceeding and that during the pendency of such claim, American Universal may investigate such claim and interpose, at its own expense, in the proceeding where such claim is to be adjudicated any defense or defenses which it may deem available to Old Republic or its liquidator, receiver or statutory successor. The expense thus incurred by American Universal shall be chargeable subject to court approval, aganist Old Republic as a part of the expense of liquidation to the extent of a proportionate share of the benefits which may accrue to Old Republic

solely as a result of the defense undertaken by American Universal."

This Addendum is effective retroactively to the first day of May 1963.

IN WITNESS WHEREOF, the parties have signed this addendum the 7th day of February, 1964.

OLD REPUBLIC LIFE INSURANCE COMPANY,

By CHARLES S. WILKES.

AMERICAN UNIVERSAL LIFE INSURANCE CO.,

By JOSEPH KUTTEN, *Pres.*

EXHIBIT 3

CREDIT LIFE REINSURANCE AGREEMENT

Between

PILOT LIFE INSURANCE COMPANY of Greensboro, North Carolina, herein called "Pilot Life,"

and

AMERICAN UNIVERSAL LIFE INSURANCE COMPANY of Clayton, Missouri, herein called "American Universal."

ARTICLE I

On and after February 1, 1957, Pilot Life agrees to reinsure with American Universal one hundred per cent (100%) of the total of all Credit Life issued by Pilot Life covering the debtors of Aetna Finance Company, its affiliates and subsidiaries, and American Universal agrees to accept such reinsurance automatically.

ARTICLE II

1. The liability of American Universal on all reinsurances shall begin simultaneously with that of Pilot Life and in no event shall the reinsurance of American Universal be in force and binding unless the policy issued by Pilot Life is in force.

2. In all reinsurances the liability of American Universal shall cease when the liability of Pilot Life ceases.

3. If, through inadvertence or oversight, Pilot Life fails to notify American Universal of automatic reinsurance on any risk upon which American Universal should have been bound in accordance with the terms of this agreement, such reinsurance shall nevertheless be held to be in force.

ARTICLE III

1. Reinsurance payments to American Universal shall be made on or before the twenty-fifth day of each calendar month based on premium received by Pilot Life during the preceding calendar month on all policies reinsured by American Universal.

2. The premium for all reinsurance under this agreement shall be ninety-eight per cent (98%) of the adjusted gross premiums for all policies reinsured hereunder. Adjusted gross premium is gross premium paid less any premium refunded for cancellation of insurances.

3. From the reinsurance premium due American Universal shall be deducted and withheld by Pilot Life:

A. the following expenses which are assumed by American Universal;

(1) all premium, occupational and privilege taxes applicable to the insurance,

(2) the cost of policy forms,

(3) any special claim expense incurred by Pilot Life in accordance with Section 3 of Article IV hereof, and

(4) any commissions paid to or retained by agents for writing the insurance; and

B. the total of all claims paid under reinsured policies during the period for which the reinsurance premium is due.

4. If, at the time established for making any premium remittance, the total of the deductions listed in the preceding Section of this Article exceeds ninety-eight per cent (98%) of the adjusted gross premium for the period covered, American Universal shall pay to Pilot Life the amount of such excess upon receipt of a statement of the amount of such excess.

5. American Universal shall maintain reserves on all insurance reinsured under this agreement either on the basis required by the State of Missouri or on the basis required by any other state where such insurance is issued, whichever basis produces the larger reserve.

6. If this agreement is terminated as to new reinsurance, American Universal shall, nevertheless, be liable to Pilot Life for payment of all claims arising out of insurance previously reinsured hereunder and shall pay Pilot Life the amount of any such claims paid by Pilot Life upon receipt of a statement of the amount of any such claims.

ARTICLE IV

1. American Universal shall be liable to Pilot Life for the benefits covered by reinsurance hereunder to the same extent as Pilot Life is liable to the persons insured for such benefits and all reinsurance shall be subject to the terms and conditions of the policy under which Pilot Life is liable.

2. Whenever a claim is made under a policy of Pilot Life reinsured under this agreement, it shall be considered by American Universal to be a claim for the full amount of reinsurance on such policy and American Universal shall abide by the settlement made by Pilot Life and shall pay the full amount of reinsurance.

3. Any suit or claim may be contested or compromised on the part of Pilot Life and in case of reduction of the claim made upon Pilot Life, the claim made upon American Universal shall be reduced accordingly. Any special expense incurred by Pilot Life in defending or investigating any claim shall be borne by American Universal. Compensation of officers and employees of Pilot Life shall not be deemed a claim expense.

4. On or before the twenty-fifth day of each January, Pilot Life shall furnish American Universal a statement showing the amount of insurance in force under this agreement, the amount of the earned premium, the amount of the unearned premium, and the totals of all claims and expenses under policies reinsured hereunder during the preceding calendar year, all as of December thirty-first of the preceding year.

ARTICLE V

1. This agreement shall be unlimited in its duration except that it may be terminated as to new reinsurance at any time upon written notice of either party to the other.

2. This agreement may be altered at any time by mutual consent of the parties, either by addendum or by correspondence signed by responsible officials of the parties, and such addendum or correspondence shall be binding on the parties and be deemed to be an integral part of this agreement.

ARTICLE VI

American Universal shall have the right and opportunity at any reasonable time to inspect all records of Pilot Life relating to reinsurance under this agreement.

ARTICLE VII

1. Any disputes and differences between the two parties to this agreement upon which an amicable understanding cannot be reached are to be decided by arbitration and the arbitrators, who shall regard this agreement from the standpoint of practical business and equity rather than from that of strict law, are empowered to determine as to the interpretation of the treaty obligation.

2. The court of arbitration, which is to be held in the City of Greensboro, North Carolina, shall consist of three arbitrators who must be officers of life insurance companies other than the parties to this agreement. One of the arbitrators is to be appointed by Pilot Life, the second by American Universal and the third is to be selected by these two representatives before the beginning of the arbitration. Should one of the parties decline to appoint an arbitrator or should the two arbitrators fail to agree on a third, the appointment shall be made by the president of the Life Insurers Conference.

3. The arbitrators are not bound by any rules of law. They shall decide by a majority of votes and from their written decision there can be no appeal. The cost of arbitration shall be borne by the losing party unless the arbitrators shall decide otherwise.

ARTICLE VIII

This is an agreement solely between Pilot Life and American Universal. The acceptance of reinsurance hereunder shall not create any right or legal relation whatever between American Universal and any person insured or any beneficiary under any policy of Pilot Life which may be reinsured hereunder.

IN WITNESS WHEREOF, Pilot Life Insurance Company and American Universal Life Insurance Company, have, by their respective officers, executed and delivered this agreement in duplicate, this 2nd day of July, 1957.

PILOT LIFE INSURANCE COMPANY,
By R. J. JONES,
Group Actuary.

Attest:
_____ _____, *Secretary.*

AMERICAN UNIVERSAL LIFE INSURANCE COMPANY,
By JOSEPH KUTTEN,
President.

Attest:
_____ _____, *Secretary.*

[Rider No. 1]

PILOT LIFE INSURANCE COMPANY,
Greensboro, N.C.

Rider to be attached to and made part of Credit Life Reinsurance Agreement issued to AMERICAN UNIVERSAL LIFE INSURANCE COMPANY.

Amendment to be attached to and made a part of Credit Life Reinsurance Agreement between Pilot Life Insurance Company and American Universal Life Insurance Company bearing the effective date of February 1, 1957.

Said Agreement is hereby amended, effective December 1, 1961, by substituting for the words and figures "ninety-eight percent (98%)" where they appear in sections 2 and 4 of Article III of said Agreement the words and figures "ninety eight and three-fourths percent (98¾%)".

This change in reinsurance premium rates shall apply to premiums for the calendar month December 1961 and thereafter.

Any provisions of the Reinsurance Agreement inconsistent with the terms of this Rider are hereby declared void and of no effect.

Nothing contained in this Rider shall be construed to alter or amend any provisions of the Reinsurance Agreement except as specifically provided herein.

JANUARY 17, 1962.

PILOT LIFE INSURANCE COMPANY,
By ———— ————, *Secretary.*
———— ————, *Registar.*

AMERICAN UNIVERSAL LIFE INSURANCE COMPANY,
By JOSEPH KUTTEN.
CASIMER L. MUSULAK, *Witness.*

[Rider No. 2]

PILOT LIFE INSURANCE COMPANY,
Greensboro, N.C.

Rider to be attached to and made part of Credit Life Reinsurance Agreement issued to AMERICAN UNIVERSAL LIFE INSURANCE COMPANY. Effective February 1, 1957.

The above described Reinsurance Agreement is hereby amended, effective September 30, 1963, by adding to Article IV thereof the following section 5:

"5—As of September 30, 1964 and annually thereafter, American Universal may determine experience premium refunds with respect to the insurance under Creditors Group Life Insurance Policies numbers 32,527 and 32,528 issued by Pilot Life to Aetna Finance Company, a Missouri Corporation, and each of its wholly owned Texas subsidiary corporations and reinsured under this Agreement and shall pay such premium refunds to Pilot Life. Upon receipt of such premium refunds, Pilot Life shall immediately pay the entire amount of such refunds to Aetna Finance Company under the premium refund provisions of the said Group Policies.

Such premium refunds shall be determined by subtracting from eighty-five percent (85%) of the cumulative total of the life insurance premiums earned under such Group Policies the cumulative total of all

death claims incurred under such Group Policies and the cumulative total of all premium refunds made under the terms of this provision."

Any provisions of the Reinsurance Agreement inconsistent with the term of this Rider are hereby declared void and of no effect.

Nothing contained herein shall be construed to alter or amend any provisions of the Reinsurance Agreement except as specifically provided herein.

JANUARY 31, 1964.

———— ————, *Registrar.*

Date: Feb. 5, 1964.

PILOT LIFE INSURANCE COMPANY,
By ———— ————, *Secretary.*

AMERICAN UNIVERSAL LIFE INSURANCE COMPANY,
By JOSEPH KUTTEN, *Pres.*

Witness: GERALD M. KANTOR.

EXHIBIT 4

ACCIDENT AND HEALTH REINSURANCE AGREEMENT

Between

PILOT LIFE INSURANCE COMPANY of Greensboro, North Carolina, herein called "Pilot Life,"

and

AMERICAN UNIVERSAL LIFE INSURANCE COMPANY of Clayton, Missouri, herein called "American Universal."

ARTICLE I

On and after July 1, 1957, Pilot Life agrees to reinsure with American Universal one hundred per cent (100%) of the total of all Credit Accident and Health issued by Pilot Life covering the debtors of Aetna Finance Company, its affiliates and subsidiaries, and American Universal agrees to accept such reinsurance automatically.

ARTICLE II

1. The liability of American Universal on all reinsurances shall begin simultaneously with that of Pilot Life and in no event shall the reinsurance of American Universal be in force and binding unless the policy issued by Pilot Life is in force.

2. In all reinsurances the liability of American Universal shall cease when the liability of Pilot Life ceases.

3. If, through inadvertence or oversight, Pilot Life fails to notify American Universal of automatic reinsurance on any risk upon which American Universal should have been bound in accordance with the terms of this agreement, such reinsurance shall nevertheless be held to be in force.

ARTICLE III

1. Reinsurance payments to American Universal shall be made on or before the twenty-fifth of each calendar month, on a monthly term basis, based on all accident and health insurance in force during the previous month on policies reinsured with American Universal.

2. The premium payable in any month shall be ninety-eight per cent (98%) of the earned premiums for the previous month for all accident and health policies reinsured hereunder. Earned premiums for any month on such policies are all premiums written during such month, less returned premiums on such policies during such month, plus the unearned premium reserves on such policies at the beginning of such month, and less the unearned premium reserves on such policies at the end of such month.

3. From the reinsurance premium due American Universal shall be deducted and withheld by Pilot Life:

A. the following expenses which are assumed by American Universal:

(1) all premium, occupational and privilege taxes applicable to the insurance,

(2) the cost of policy forms,

(3) any special claim expense incurred by Pilot Life in accordance with Section 3 of Article IV hereof, and

(4) any commissions paid to or retained by agents for writing the insurance; and

B. the total of all claims paid under reinsured policies during the period for which the reinsurance premium is due.

4. If, at the time establish for making any premium remittance, the total of the deductions listed in the preceding Section of this Article exceeds ninety-eight per cent (98%) of the earned premium for the period covered, American Universal shall pay to Pilot Life the amount of such excess upon receipt of a statement of the amount of such excess.

5. If this agreement is terminated as to new insurance, Pilot Life shall nevertheless be liable to American Universal for payment of monthly reinsurance premiums until all premiums on policies reinsured with American Universal prior to the termination have been earned, and American Universal shall nevertheless be liable to Pilot Life for payment of all claims arising out of policies reinsured with American Universal prior to the termination. After all reinsurance premiums have been paid, American Universal shall pay Pilot Life the amount of any claims on such reinsured policies, which claims were paid by Pilot Life and not deducted from reinsurance premiums, upon receipt of a statement of the amount of any such claims.

ARTICLE IV

1. American Universal shall be liable to Pilot Life for the benefits covered by reinsurance hereunder to the same extent as Pilot Life is liable to the persons insured for such benefits and all reinsurance shall be subject to the terms and conditions of the policy under which Pilot Life is liable.

2. Whenever a claim is made under a policy of Pilot Life reinsured under this agreement, it shall be considered by American Universal to be a claim for the full amount of reinsurance on such policy and American Universal shall abide by the settlement made by Pilot Life and shall pay the full amount of reinsurance.

3. Any suit or claim may be contested or compromised on the part of Pilot Life and in case of reduction of the claim

made upon Pilot Life, the claim made upon American Universal shall be reduced accordingly. Any special expense incurred by Pilot Life in defending or investgating any claim shall be borne by American Universal. Compensation of officers and employees of Pilot Life shall not be deemed a claim expense.

4. On or before the twenty-fifth day of each January, Pilot Life shall furnish American Universal a statement showing the amount of insurance in force under this agreement, the amount of the earned premium, the amount of the unearned premium, and the totals of all claims and expenses under policies reinsured hereunder during the preceding calendar year, all as of December thirty-first of the preceding year.

ARTICLE V

1. This agreement shall be unlimited in its duration except that it may be terminated as to new reinsurance at any time upon written notice of either party to the other.

2. This agreement may be altered at any time by mutual consent of the parties, either by addendum or by correspondence signed by responsible officials of the parties, and such addendum or correspondence shall be binding on the parties and be deemed to be an integral part of this agreement.

ARTICLE VI

American Universal shall have the right and opportunity at any reasonable time to inspect all records of Pilot Life relating to reinsurance under this agreement.

ARTICLE VII

1. Any disputes and differences between the two parties to this agreement upon which an amicable understanding cannot be reached are to be decided by arbitration and the arbitrators, who shall regard this agreement from the standpoint of practical business and equity rather than from that of strict law, are empowered to determine as to the interpretation of the treaty obligation.

2. The court of arbitration, which is to be held in the City of Greensboro, North Carolina, shall consist of three arbitrators who must be officers of life insurance companies other than the parties to this agreement. One of the arbitrators is to be appointed by Pilot Life, the second by American Universal and the third is to be selected by these two representatives before the beginning of the arbitration. Should one of the parties decline to appoint an arbitrator or should the two arbitrators fail to agree on a third, the appointment shall be made by the president of the Life Insurers Conference.

3. The arbitrators are not bound by any rules of law. They shall decide by a majority of votes and from their written decision there can be no appeal. The cost of arbitration shall be borne by the losing party unless the arbitrators shall decide otherwise.

ARTICLE VIII

This is an agreement solely between Pilot Life and American Universal. The acceptance of reinsurance hereunder shall not create any right or legal relation whatever between American Universal and any person insured or any beneficiary under any policy of Pilot Life which may be reinsured hereunder.

IN WITNESS WHEREOF, Pilot Life Insurance Company and American Universal Life Insurance Company, have, by their respective officers, executed and delivered this agreement in duplicate, this 2nd day of July, 1957.

PILOT LIFE INSURANCE COMPANY,
By R. J. JONES, *Group Actuary*

Attest:

———— ————, *Secretary.*

AMERICAN UNIVERSAL LIFE INSURANCE COMPANY,

By
JOSEPH KUTTEN, *President.*

Attest:

M. BROWN.

[Rider No. 1]

PILOT LIFE INSURANCE COMPANY,
Greensboro, N.C.

Rider to be attached to and made a part of Accident and Health Reinsurance Agreement issued to AMERICAN UNIVERSAL LIFE INSURANCE COMPANY.

Amendment to be attached to and made a part of Accident And Health Reinsurance Agreement between Pilot Life Insurance Company and American Universal Life Insurance Company bearing the effective date of July 1, 1957.

Said Agreement is hereby amended, effective December 1, 1961, by substituting for the words and figures "ninety-eight percent (98%)" where they appear in sections 2 and 4 of Article III of said Agreement the words and figures "ninety eight and three-fourths percent (98¾%)".

This change in reinsurance premium rates shall apply to premiums for the calendar month December 1961 and thereafter.

Any provisions of the Reinsurance Agreement inconsistent with the terms of this Rider are hereby declared void and of no effect.

Nothing contained in this Rider shall be construed to alter or amend any provisions of the Reinsurance Agreement except as specifically provided herein.

JANUARY 17, 1962.

PILOT LIFE INSURANCE COMPANY,
By ———— ————, *Secretary.*

———— ————, *Registrar.*

AMERICAN UNIVERAL LIFE INSURANCE COMPANY,
By JOSEPH KUTTEN.

CASIMER L. MUSULAK, *Witness.*

[Rider No. 2]

PILOT LIFE INSURANCE COMPANY,
Greensboro, N.C.

Rider to be attached to and made a part of Credit Accident and Health Reinsurance Agreement—Effective July 1, 1957 issued to AMERICAN UNIVERAL LIFE INSURANCE COMPANY.

The above described Reinsurance Agreement is hereby amended, effective September 30, 1963, by adding to Article IV thereof the following section 5:

"5—As of September 30, 1964 and annually thereafter, American Universal may determine experience premium refunds with respect to the insurance under Creditors Group Accident and Health Insurance Policy number 32,528 issued by Pilot Life to Aetna Finance Company, a Missouri Corporation, and each of its wholly owned Texas subsidiary corporations and reinsured under this Agreement and shall pay such premium refunds to Pilot Life. Upon receipt of such premium refunds, Pilot Life shall immediately pay the entire amount of such refunds to Aetna Finance Company under the premium refund provisions of the said Group Policy.

Such premium refunds shall be determined by subtracting from eighty-five percent (85%) of the cumulative total of the accident and health insurance premiums earned under such Group Policy the cumulative total of all accident and health claims incurred under such Group Policy and the cumulative total of all premium refunds made under the terms of this provision."

Any provisions of the Reinsurance Agreement inconsistent with the terms of this Rider are hereby declared void and of no effect.

Nothing contained herein shall be construed to alter or amend any provisions of the Reinsurance Agreement except as specifically provided herein.

JANUARY 31, 1964.

PILOT LIFE INSURANCE COMPANY,
By ———— ————, *Secretary.*

———— ————, *Registrar.*

Date: Feb. 5, 1964.

AMERICAN UNIVERAL LIFE INSURANCE COMPANY,
By JOSEPH KUTTEN, Pres.

Witness: GERALD M. KANTOR.

EXHIBIT 5

Credit Life Reinsurance Agreement

Between

National Fidelity Life Insurance Company of Kansas City, Missouri, herein called "National Fidelity,"

and

American Universal Life Insurance Company of Clayton, Missouri, herein called "American Universal."

ARTICLE I

On and after February 1, 1957, National Fidelity agrees to reinsure with American Universal one hundred per cent (100%) of the total of all Credit Life issued by National Fidelity covering the debtors of Aetna Finance Company, its affiliates and subsidiaries, and American Universal agrees to accept such reinsurance automatically.

ARTICLE II

1. The liability of American Universal on all reinsurances shall begin simultaneously with that of National Fidelity and in no event shall the reinsurance of American Universal be in force and binding unless the policy issued by National Fidelity is in force.

2. In all reinsurances the liability of American Universal shall cease when the liability of National Fidelity ceases.

3. If, through inadvertence or oversight, National Fidelity fails to notify American Universal of automatic reinsurance on any risk upon which American Universal should have been bound in accordance with the terms of this agreement, such reinsurance shall nevertheless be held to be in force.

ARTICLE III

1. Reinsurance payments to American Universal shall be made on or before the twenty-fifth day of each calendar month based on premium received by National Fidelity during the preceding calendar month on all policies reinsured by American Universal.

2. The premium for all reinsurance under this agreement shall be ninety-eight per cent (98%) of the adjusted gross premiums for all policies reinsured hereunder. Adjusted gross premium is gross premium paid less any premium refunded for cancellation of insurance.

3. From the reinsurance premium due American Universal shall be deducted and withheld by National Fidelity:

A. the following expenses which are assumed by American Universal;

(1) all premium, occupational and privilege taxes applicable to the insurance,

(2) the cost of policy forms,

(3) any special claim expense incurred by National Fidelity in accordance with Section 3 of Article IV hereof, and

(4) any commissions paid to or retained by agents for writing the insurance; and

B. the total of all claims paid under reinsured policies during the period for which the reinsurance premium is due.

4. If, at the time established for making any premium remittance, the total of the deductions listed in the preceding Section of this Article exceeds ninety-eight per cent (98%) of the adjusted gross premium for the period covered, American Universal shall pay to National Fidelity the amount of such excess upon receipt of a statement of the amount of such excess.

5. American Universal shall maintain reserves on all insurance reinsured under this agreement either on the basis required by the state of Missouri or on the basis required by any other state where such insurance is issued, whichever basis produces the larger reserve.

6. If this agreement is terminated as to new reinsurance, American Universal shall, nevertheless, be liable to National Fidelity for payment of all claims arising out of insurance previously reinsured hereunder and shall pay National Fidelity the amount of any such claims paid by National Fidelity upon receipt of a statement of the amount of any such claims.

ARTICLE IV

1. American Universal shall be liable to National Fidelity for the benefits covered by reinsurance hereunder to the same extent as National Fidelity is liable to the persons insured for such benefits and all reinsurance shall be subject to the terms and conditions of the policy under which National Fidelity is liable.

2. Whenever a claim is made under a policy of National Fidelity reinsured under this agreement, it shall be considered by American Universal to be a claim for the full amount of reinsurance on such policy and American Universal shall abide by the settlement made by National Fidelity and shall pay the full amount of reinsurance.

3. Any suit or claim may be contested or compromised on the part of National Fidelity and in case of reduction of the claim made upon National Fidelity, the claim made upon American Universal shall be reduced accordingly. Any special expense incurred by National Fidelity in defending or investigating any claim shall be borne by American Universal. Compensation of officers and employees of National Fidelity shall not be deemed a claim expense.

4. On or before the twenty-fifth day of each January, National Fidelity shall furnish American Universal a statement showing the amount of insurance in force under this agreement, the amount of the earned premium, the amount of the unearned premium, and the totals of all claims and expenses under policies reinsured hereunder during the preceding calendar year, all as of December thirty-first of the preceding year.

ARTICLE V

1. This agreement shall be unlimited in its duration except that it may be terminated as to new reinsurance at any time upon written notice of either party to the other.

2. This agreement may be altered at any time by mutual consent of the parties, either by addendum or by correspondence signed by responsible officials of the parties, and such addendum or correspondence shall be binding on the parties and be deemed to be an integral part of this agreement.

ARTICLE VI

American Universal shall have the right and opportunity at any reasonable time to inspect all records of National Fidelity relating to reinsurance under this agreement.

ARTICLE VII

1. Any disputes and differences between the two parties to this agreement upon which an amicable understanding cannot be reached are to be decided by arbitration and the arbitrators, who shall regard this agreement from the standpoint of practical business and equity rather than from that of strict law, are empowered to determine as to the interpretation of the treaty obligation.

2. The court of arbitration, which is to be held in the City of Greensboro, North Carolina, shall consist of three arbitrators who must be officers of life insurance companies other than the parties to this agreement. One of the arbitrators is to be appointed by National Fidelity, the second by American Universal and the third is to be selected by these two representatives before the beginning of the arbitration. Should one of the parties decline to appoint an arbitrator or should the two arbitrators fail to agree on a third, the appointment shall be made by the president of the Life Insurers Conference.

3. The arbitrators are not bound by any rules of law. They shall decide by a majority of votes and from their written decision there can be no appeal. The cost of arbitration shall be borne by the losing party unless the arbitrators shall decide otherwise.

ARTICLE VIII

This is an agreement solely between National Fidelity and American Universal. The acceptance of reinsurance hereunder shall not create any right or legal relation whatever between American Universal and any person insured or any beneficiary under any policy of National Fidelity which may be reinsured hereunder.

IN WITNESS WHEREOF, National Fidelity Life Insurance Company and American Universal Life Insurance

Company, have, by their respective officers, executed and delivered this agreement in duplicate, this 2nd day of July, 1957.

NATIONAL FIDELITY LIFE INSURANCE COMPANY,
By ———— ————, *President.*

Attest:

———— ————, *Secretary.*

AMERICAN UNIVERSAL LIFE INSURANCE COMPANY,
JOSEPH KUTTEN, *President.*

Attest:

By ———— ————, *Secretary.*

NATIONAL FIDELITY LIFE INSURANCE COMPANY,
Kansas City, Missouri.

RIDER

Rider to be attached to and made a part of Credit Life Reinsurance Agreement issued to AMERICAN UNIVERSAL LIFE INSURANCE COMPANY.

Amendment to be attached to and made a part of Credit Life Reinsurance Agreement between National Fidelity Life Insurance Company and American Universal Life Insurance Company bearing the effective date of February 1, 1957.

Said Agreement is hereby amended, effective December 1, 1961, by substituting for the words and figures "ninety-eight percent (98%)" where they appear in Sections 2 and 4 of Article III of said Agreement the words and figures "ninety-eight and three-fourths percent (98¾%)".

This change in reinsurance premium rates shall apply to premiums for the calendar month December 1961 and thereafter.

Any provisions of the Reinsurance Agreement inconsistent with the terms of this Rider are hereby declared void and of no effect.

Nothing contained in this Rider shall be construed to alter or amend any provisions of the Reinsurance Agreement except as specifically provided herein.

FEBRUARY 7, 1962.

NATIONAL FIDELITY LIFE INSURANCE COMPANY,

By _____ _____,

Executive Vice President.

RICHARD M. SMITH,

Assistant Secretary.

AMERICAN UNIVERSAL LIFE INSURANCE COMPANY,

By JOSEPH KUTTEN.

_____ _____,

Witness.

EXHIBIT 6

ACCIDENT AND HEALTH REINSURANCE AGREEMENT

Between

NATIONAL FIDELITY LIFE INSURANCE COMPANY of Kansas City, Missouri, herein called "National Fidelity"

and

AMERICAN UNIVERSAL LIFE INSURANCE COMPANY of Clayton, Missouri, herein called "American Universal."

ARTICLE I

On and after July 1, 1957, National Fidelity agrees to reinsure with American Universal one hundred percent (100%) of the total of all Credit Accident and Health issued by National Fidelity covering the debtors of Aetna Finance Company, its affiliates and subsidiaries, and American Universal agrees to accept such reinsurance automatically.

ARTICLE II

1. The liability of American Universal on all reinsurances shall begin simultaneously with that of National Fidelity and in no event shall the reinsurance of American Universal be in force and binding unless the policy issued by National Fidelity is in force.

2. In all reinsurances the liability of American Universal shall cease when the liability of National Fidelity ceases.

3. If, through inadvertence or oversight, National Fidelity fails to notify American Universal of automatic reinsurance on any risk upon which American Universal should have been bound in accordance with the terms of this agreement, such reinsurance shall nevertheless be held to be in force.

ARTICLE III

1. Reinsurance payments to American Universal shall be made on or before the twenty-fifth of each calendar month, on a monthly term basis, based on all accident and health insurance in force during the previous month on policies reinsured with American Universal.

2. The premium payable in any month shall be ninety-eight per cent (98%) of the earned premiums for the previous month for all accident and health policies reinsured hereunder. Earned premiums for any month on such policies are all premiums written during such month, less returned premiums on such policies during such month, plus the unearned premium reserves on such policies at the beginning of such month, and less the unearned premium reserves on such policies at the end of such month.

3. From the reinsurance premium due American Universal shall be deducted and withheld by National Fidelity:

A. the following expenses which are assumed by American Universal:

(1) all premium, occupational and privilege taxes applicable to the insurance,

(2) the cost of policy forms,

(3) any special claim expense incurred by National Fidelity in accordance with Section 3 of Article IV hereof, and

(4) any commissions paid to or retained by agents for writing the insurance; and

B. the total of all claims paid under reinsured policies during the period for which the reinsurance premium is due.

4. If, at the time established for making any premium remittance, the total of the deductions listed in the preceding Section of this Article exceeds ninety-eight per cent (98%) of the earned premium for the period covered, American Universal shall pay to National Fidelity the amount of such excess upon receipt of a statement of the amount of such excess.

5. If this agreement is terminated as to new insurance, National Fidelity shall nevertheless be liable to American Universal for payment of monthly reinsurance premiums until all premiums on policies reinsured with American Universal prior to the termination have been earned, and American Universal shall nevertheless be liable to National Fidelity for payment of all claims arising out of policies reinsured with American Universal prior to the termination. After all reinsurance premiums have been paid, American Universal shall pay National Fidelity the amount of any claims on such reinsured policies, which claims were paid by National Fidelity and not deducted from reinsurance premiums, upon receipt of a statement of the amount of any such claims.

ARTICLE IV

1. American Universal shall be liable to National Fidelity for the benefits covered by reinsurance hereunder to the same extent as National Fidelity is liable to the persons insured for such benefits and all reinsurance shall be subject to the terms and conditions of the policy under which National Fidelity is liable.

2. Whenever a claim is made under a policy of National Fidelity reinsured under this agreement, it shall be considered by American Universal to be a claim for the full amount of reinsurance on such policy and American Universal shall abide by the settlement made by National Fidelity and shall pay the full amount of reinsurance.

3. Any suit or claim may be contested or compromised on the part of National Fidelity and in case of reduction of the claim made upon National Fidelity, the claim made upon American Universal shall be reduced accordingly. Any special expense incurred by National Fidelity in defending or investigating any claim shall be borne by American Uni-

versal. Compensation of officers and employees of National Fidelity shall not be deemed a claim expense.

4. On or before the twenty-fifth day of each January, National Fidelity shall furnish American Universal a statement showing the amount of insurance in force under this agreement, the amount of the earned premium, the amount of the unearned premium, and the totals of all claims and expenses under policies reinsured hereunder during the preceding calendar year, all as of December thirty-first of the preceding year.

ARTICLE V

1. This agreement shall be unlimited in its duration except that it may be terminated as to new reinsurance at any time upon written notice of either party to the other.

2. This agreement may be altered at any time by mutal consent of the parties, either by addendum or by correspondence signed by responsible officials of the parties, and such addendum or correspondence shall be binding on the parties and to be deemed to be an integral part of this agreement.

ARTICLE VI

American Universal shall have the right and opportunity at any reasonable time to inspect all records of National Fidelity relating to reinsurance under this agreement.

ARTICLE VII

1. Any disputes and differences between the two parties to this agreement upon which an amicable understanding cannot be reached are to be decided by arbitration and the arbitraters, who shall regard this agreement from the standpoint of practical business and equity rather than from that of strict law, are empowered to determine as to the interpretation of the treaty obligation.

2. The court of arbitration, which is to be held in the City of Greensboro, North Carolina, shall consist of three arbitrators who must be officers of life insurance companies other than the parties to this agreement. One of the arbitrators is to be appointed by National Fidelity, the second by American Universal and the third is to be selected by these

BEST COPY AVAILABLE

two representatives before the beginning of the arbitration. Should one of the parties decline to appoint an arbitrator or should the two arbitrators fail to agree on a third, the appointment shall be made by the president of the Life Insurers Conference.

3. The arbitrators are not bound by any rules of law. They shall decide by a majority of votes and from their written decision there can be no appeal. The cost of arbitration shall be borne by the losing party unless the arbitrators shall decide otherwise.

ARTICLE VIII

This is an agreement solely between National Fidelity and American Universal. The acceptance of reinsurance hereunder shall not create any right or legal relation whatever between American Universal and any person insured or any beneficiary under any policy of National Fidelity which may be reinsured hereunder.

IN WITNESS WHEREOF, National Fidelity Life Insurance Company and American Universal Life Insurance Company, have, by their respective officers, executed and delivered this agreement in duplicate, this 2nd day of July, 1957.

NATIONAL FIDELITY LIFE INSURANCE COMPANY,

By _____ _____ *Vice President.*

Attest:

_____ _____, *Secretary.*

AMERICAN UNIVERSAL LIFE INSURANCE COMPANY,

By JOSEPH KUTTEN, *President.*

Attest:

_____ _____.

NATIONAL FIDELITY LIFE INSURANCE COMPANY,
Kansas City, Missouri.

RIDER

Rider to be attached to and made a part of Accident and Health Reinsurance issued to AMERICAN UNIVERSAL LIFE INSURANCE COMPANY.

Amendment to be attached to and made a part of Accident and Health Reinsurance Agreement between National Fidelity Life Insurance Company and American Universal Life Insurance Company bearing the effective date of July 1, 1957.

Said Agreement is hereby amended, effective December 1, 1961, by substituting for the words and figures "ninety-eight percent (98%)" where they appear in Sections 2 and 4 of Article III of said Agreement the words and figures "ninety-eight and three-fourths percent (98¾%)".

This change in reinsurance premium rates shall apply to premiums for the calendar month December 1961 and thereafter.

Any provisions of the Reinsurance Agreement inconsistent with the terms of this Rider are hereby declared void and of no effect.

Nothing contained in this Rider shall be construed to alter or amend any provisions of the Reinsurance Agreement except as specifically provided herein.

FEBRUARY 7, 1962.

NATIONAL FIDELITY LIFE INSURANCE COMPANY,

By ———— ————,

Executive Vice President.

RICHARD MACSMITH,

Assistant Secretary.

AMERICAN UNIVERSAL LIFE INSURANCE COMPANY,

By JOSEPH KUTTEN.

HELEN L. ————, *Witness.*

EXHIBIT 24

DIVISION OF INSURANCE

DEPARTMENT OF BUSINESS AND ADMINISTRATION

CERTIFIED COPY

I, ROBERT D. SCHARZ, Superintendent of the Division of Insurance Department of Business and Administration of the State of Missouri, do hereby certify that the annexed pages are a true and correct copy of the original

Report of Examination of the

AMERICAN UNIVERSAL LIFE INSURANCE COMPANY
(Now known as ITT HAMILTON LIFE INSURANCE COMPANY)

as of December 31, 1964.

which said original is now on file in this Division.

IN TESTIMONY WHEREOF, I have hereunto set my hand and caused to be hereto affixed the seal of said Division, at my office in the City of Jefferson, this 10th day of March 19 62

ROBERT D. SCHARZ
SUPERINTENDENT

By
DEPUTY SUPERINTENDENT

By Charles Salmon

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CLAYTON, MISSOURI,
October 8, 1965.

Hon. ROBERT D. SCHARZ,
Superintendent of Insurance, Division of Insurance,
Jefferson City, Missouri.

SIR: In accordance with your certificate of authority, an examination has been made of the records, affairs and financial condition of the AMERICAN UNIVERSAL LIFE INSURANCE COMPANY at its home office and principal place of business located at 111 South Meramec, Clayton, Missouri. This examination began on August 30, 1965, and was concluded on October 8, 1965. The following report of such examination is herewith respectfully submitted.

SCOPE OF EXAMINATION

The American Universal Life Insurance Company, hereinafter referred to as such or as the "Company," was last examined by representatives of your Division as of September 30, 1961. This examination covers the period from that date through December 31, 1964.

The examination included a checking of trial balances into the office copies of the Company's annual reports for the years under review; a testing of income and disbursements to general ledger postings; the verification and evaluation of assets; the establishment of liabilities; and a general review of other records and procedures considered necessary to the examination.

The various balance sheet items are commented on under their respective captions in subsequent sections of this report.

HISTORY

The Company was incorporated on August 8, 1955, as a stipulated premium company for the purpose of writing life and accident and health insurance. The Company commenced business on September 22, 1955.

The initial capitalization of the Company was $50,000.00 consisting of one hundred (100) shares with a par value of $250.00 each and a paid in surplus of $25,000.00. On September 6, 1957, the Articles of Incorporation were amended to increase the capital stock to $100,000.00 consisting of

100,000 shares with a par value of $1.00 each. The increase was accomplished through the declaration of a three hundred (300%) per cent stock dividend. For each share of $250.00 par value stock, the holder was issued 1,000 shares with a par value of $1.00 per share. On September 7, 1965, the capital stock was increased to $1,000,000.00 consisting of 1,000,000 shares with a par value of $1.00 per share and paid for by transfer from surplus. The Company is currently licensed to do the business of life and accident and sickness insurance in accordance with the revised statutes of 1959, and amendments thereto.

MANAGEMENT AND CONTROL

The Company operates on a strictly proprietary plan through a board of directors comprised of nine (9) members elected annually by the stockholders. The board of directors as of December 31, 1964, was comprised of the following members duly elected by the stockholders in accordance with the applicable provisions of the by-laws:

Joseph Kutten
Gerald M. Kantor
David R. Corwin
Edward P. Kessler
Richard L. Yalem
Palmer Shepard
Marcus Brown
Ben Weinbach
Jack Sofian

The duly elected officers of the Company as of December 31, 1964, consisted of the following:

Name/Office

Joseph Kutten, President
Jack Sofian, Vice-President
Gerald M. Kantor, Secretary and Registrar
M. Lerner, Assistant Secretary
Casimir L. Musielak, Treasurer

The ITT Aetna Finance Company owns one hundred (100%) per cent of the Company's outstanding capital stock, and is a subsidiary of the International Telephone and Telegraph Corporation.

CORPORATE RECORDS

The minutes of the meetings of the shareholders and the board of directors for the period under review were in proper order and form. There were four meetings of the board of directors for the period covered by this examination, and perfect attendance was indicated.

There were no changes in the Articles of Incorporation nor the by-laws for the period covered.

FIDELITY BONDS AND OTHER INSURANCE

The Company is protected against fraudulence and/or dishonesty through a blanket fidelity bond covering the International Telephone and Telegraph Corporation and all its subsidiary corporations with the bond being issued by the Aetna Casualty and Security Company, Hartford, Connecticut.

TERRITORY AND PLAN OF OPERATION

As of the examination date, the Company was licensed in Missouri only to do the business of life and accident and sickness insurance. Income is derived principally from credit life insurance and credit accident and health insurance on the debtors of the ITT Aetna Finance Company and from group life and group accident and health insurance on employees of the International Telephone and Telegraph Corporation. All business is obtained entirely through reinsurance facilities.

REINSURANCE

The Company assumes its business through reinsurance agreements with the following companies and the agreements are commented on in the sequence as shown below:

American Bankers Life Assurance Company of Florida, Miami, Florida

Equitable Life Assurance Society of the United States, New York, New York

Insurance City Life Company, Hartford, Connecticut

National Fidelity Life Insurance Company, Kansas City, Missouri

Old Republic Life Insurance Company, Chicago, Illinois, Pilot Life Insurance Company, Greensboro, North Carolina

Under the terms of the reinsurance agreement with the American Bankers Life Assurance Company of Florida the Company assumes a percentage of the liability under certain certificates of life insurance on the lives of Aetna Finance debtors in Nevada. The Company receives monthly a reinsurance premium based on a percentage of all premiums received less premiums returned on certificates surrendered for cancellation with a percentage of incurred losses also being deducted. In the event that the deductions for the return premiums and the losses paid exceed the reinsurance premium payable, the excess is to be paid by the Company to the American Bankers.

The reinsurance agreement with the Equitable Life Assurance Society of the United States pertains to group policies issued by Equitable to the International Telephone and Telegraph Corporation of which policies the Company reinsures a certain portion of the liability falling thereunder. The agreement with Equitable provides that as soon as practicable after the end of each policy year a schedule is to be submitted to the Company by Equitable reflecting the net balance due either the Company or Equitable. Under the terms of the agreement the schedule is to show as a credit to the Company:

1. Preimums computed at a percentage of all insurance under certain group policies at the reinsurance rate.

The debits to the Company under this agreement with Equitable are to be as follows:

2. A percentage of the charge for claims.

3. A percentage of the normal retention charges under the policies as determined by Equitable's dividend formula.

4. A percentage of the normal charges under the policies as computed by Equitable's dividend formula for recovery of prior years' experience deficit.

5. A percentage of the risk charge under the policies as determined by Equitable's dividend formula.

6. The algebraic sum of "a"+"b"−"c"−"d"

with

(a.) being a percentage of (1) above

(b.) being a percentage of the dividend, if any, payable

under the policies as determined by Equitable's dividend formula.

(c.) being a percentage of the excess, if any, over premiums of all charges.

(d.) being equal to the accumulated experience loss adjustment of the prior year's net balance calculation.

7. An accumulated experience loss adjustment equal to the amount, if any, by which item (6) produces a figure less than zero.

Under the terms of the agreement with Equitable, the Company assumes no liability for individual policies issued by Equitable to a previous employee.

A summary of the annual settlement for the policy year from August 1, 1963, to August 1, 1964, by Equitable as submitted in December of 1964 is shown below by the reinsurance schedule items commented on above:

Reinsurance Schedule Items:	*Amounts*
(1) Reinsurance premiums	$2,448,621.50
(2) The percentage of the charge for claims	−1,760,249.62
(3) The percentage of the normal retention charges under policies as determined by Equitable's dividend formula	−99,734.07
(4) Recovery of prior years experience deficit	−28,436.25
(5) Risk charge	−18,056.21
(6a) A percentage of (1) above	−612,155.37
(6b) A percentage of the dividends payable	0
(6c) A percentage of the excess, if any, over premiums of all charges	70,960.37
(7) Accumulated experience loss adjustment	0
Cash amount paid to Company	950.35

The Company's account distribution based on the annual settlement from Equitable as summarized above is detailed as follows:

Group life premiums ITT employees:	
Life	$1,119,896.76
AD and D	65,063.40
	$1,184,960.16
Group A and H premiums ITT employees:	
Weekly indemnity	$18,252.98
Health	1,245,408.36
	$1,263,661.34

Group life claims ITT employees:	
Life	$619,180.12
AD and D	43,050.75
	$662,230.87
Group A and H claims ITT employees:	
Weekly indemnity	$15,887.25
Health	1,082,131.50
	$1,098,018.75
Dividends to life policyholders:	
Life	$467,815.55
AD and D	14,826.96
	$482,642.51
Dividends to A and H policyholders:	
Weekly indemnity	$1,718.24
Health	127,794.62
	$129,512.86
Group services and administration fees, life:	
Life	$32,356.16
AD and D	7,125.14
	$39,481.30
Group services and administration fees, A and H:	
Weekly indemnity	$642.42
Health	35,142.44
	$35,784.86
Cash to Company	$950.85

The Insurance City Life Company cedes to the Company 100% of all the credit life and credit accident and health insurance on business written, covering the debtors of the Aetna Finance Company in Rhode Island. The reinsurance payments are to be made monthly. The reinsurance premium is to be a percentage of the gross premiums paid less any premiums refunded for cancellation with an additional deduction being made for losses sustained. If the losses exceed the reinsurance premiums, the Company is to pay such excess to the Insurance City Life.

The National Fidelity Life Insurance Company cedes to the Company 100% of all credit life and credit accident and health insurance written covering debtors of the Aetna Finance Company, its affiliates and subsidiaries. Reinsurance payments are to be made to the Company monthly. The amount payable is to be a percentage of the earned premiums for accident and health and premiums written for life for the previous month less premium taxes, cost of policy forms, special claim expenses, agents' commissions, and claims paid. If the deductions exceed this percentage of the earned premiums then the Company is obligated to pay National Fidelity the amount of such excess.

The Company reinsures all the life insurance written by the Old Republic Life Insurance Company insuring the lives of certain debtors of the Aetna Finance Company and its subsidiaries. Under this reinsurance contract with Old Republic, the reinsurance premium is to be a percentage of the gross premiums less returns on account of cancellations. Old Republic is to pay all agents' and brokers' commissions and taxes imposed by the states. Old Republic is entitled to set off losses incurred against the reinsurance premuim due the Company. If the incurred losses exceed the reinsurance premium, the Company must pay Old Republic the amount of the resulting excess. The Company also has a reinsurance contract with Old Republic whereby the Company reinsures all disability written in combination with life insurance and all accident and health insurances providing coverage for certain debtors of the Aetna Finance Company and its subsidiaries. The reinsurance premium is to be based on a percentage of the monthly earned premiums, with Old Republic being entitled to set off losses incurred against the reinsurance premium due the Company.

The Company is the "assuming company" in several agreements with the Pilot Life Insurance Company. One agreement states that the Company assumes all insurance under a group policy issued by Pilot to the Aetna Finance Company with the exceptions of accidental death and dismemberment insurance and that part of the group life insurance on any employee exceeding $12,000.00. The reinsurance premium shall be computed on the basis of a percentage of the premium for the group policy. Pilot shall

deduct from the reinsurance premium due all special claim expense and excess morbidity charges of $65.00 for each $1,000.00 converted to individual policies and the total of all claims paid for the applicable month. If the total of the deductions exceeds the reinsurance premium otherwise due the Company, the Company must pay Pilot for the excess immediately upon the receipt of the statement.

The Company also has agreements with Pilot pertaining to credit life and credit accident and health insurance covering certain debtors of the Aetna Finance Company. The reinsurance premium payable is based on a percentage of the earned premiums for accident and health and premiums written for life for the applicable month. Pilot shall deduct from the reinsurance premium due the premium taxes, cost of policy forms, special claim expense, commissions for writing the insurance, and the total of all claims paid. Experience premium refunds may be determined by the Company for certain creditors' group policies issued by Pilot to Aetna Finance Company and each of its wholly owned Texas subsidiaries. Such refunds are to ge paid by the Company to Pilot and Pilot is to pay the entire amount to the Aetna Finance Company. The premium refunds are to be determined by taking a percentage of the cumulative total of the premiums earned less the cumulative total of all death claims incurred. The experience premium refund is to be determined annually.

In addition the Company has another reinsurance contract with Pilot whereby the Company reinsures 100% of the credit life and credit accident and health insurance written by Pilot in connection with loans made under the provisions of the North Carolina Consumer Finance Act to borrowers from the Aetna Finance Company and its affiliates. Under the terms of this agreement the reinsurance premium due the Company shall be based on a percentage of the premiums charged less any premiums refunded for cancellations. Agents commissions are deducted from the reinsurance premiums. Also under the terms of this reinsurance contract Pilot must establish a reserve equal to a percentage of the cumulative total of adjusted gross premiums. If claims and special claim expense exceed this reserve, the Company is to pay to Pilot the excess thus produced.

STATUTORY DEPOSIT

The Company had on deposit with your Division as of December 31, 1964, United States Treasury bonds with an aggregate par value of $606,000.00. The bonds were verified by a certified listing from your Division. On September 7, 1965, this deposit was increased to $2,406,000.00, par value, in United States Treasury bonds.

DIVISIONS

Stockholders

No dividends were declared or paid to stockholders for the period under review.

Policyholders

The company beginning August 1, 1963, assumed a portion of the group business written by the Equitable Life Assurance Society of the United States covering employees of the International Telephone and Telegraph Corporation. Settlement under the contract pertaining to this segment of business is made annually in December for the policy year which runs from August to August. The statement furnished by Equitable to the Company reflected as dividends paid to policyholders the following described amounts:

Life policyholders	$482,642.51
Accident and health policyholders	129,512.86
Total	$612,155.37

GROWTH OF COMPANY

The growth of the Company during the past four years is shown in the following table setting forth insurance in force, admitted assets, capital, and surplus. The figures for 1964 were taken from the financial statement presented subsequently herein, and the figures for 1961, 1962, and 1963 were taken from the respective annual statements.

Year	Insurance in force	Admitted Assets	Capital	Surplus
1961	$53,887,356	$1,776,700	$100,000	$935,590
1962	72,021,493	3,551,944	100,000	2,123,198
1963	88,300,524	4,682,437	100,000	3,073,911
1964	221,383,507	6,590,291	100,000	4,205,352

CONFLICT OF INTEREST

Members of the board of directors and officers annually sign a statement addressed to the board of directors which reads as follows:

I, the undersigned, hereby affirm that I have no material interest or affiliation which is in conflict with my official duties or is likely to conflict with such duties. If there is any such possible conflicting interest or interests this interest or interests are listed below.

ACCOUNT AND RECORDS

The Company manually maintains a general ledger, a disbursements journal, a cash receipts journal, and a general journal. The subsidiary ledger for investments consists of card files with all necessary items pertaining to the investment being entered and maintained on an individual record for each investment. Cash trial balances for the years under review were furnished by the Company, were checked into the general ledger, and were compared and reconciled to the annual statements. Various accruals of reinsurance premiums receivable, claims, and reserves are posted to the general ledger accounts.

An electronic data processing unit aids in the computations of reserves. A seriatim listing of reserves was supplied the Company by the data processing equipment as of December 31, 1964.

FINANCIAL STATEMENT

The following financial statement, with supporting schedules and exhibits, presents the financial condition of the Company as of December 31, 1964, as determined by this examination:

ASSETS

Bonds	$4,687,581.71
Stocks	130,000.00
Cash and Bank Deposits	362,097.90
Reinsurance premiums receivable	1,371,011.50
Interest due and accrued	39,500.67
Total Assets	$6,590,290.78

LIABILITIES, SURPLUS AND OTHER FUNDS

Aggregate reserve for life policies	$806,698.00
Aggregate reserve for accident and health policies	59,673.48
Policy and contract claims:	
Life	300,309.20
Accident and Health	602,293.65
Policyholders dividends payable in following year: Not yet apportioned	263,700.00
Commissions to agents due or accrued: Life $57,643.37: A&H $66,201.83	123,845.20
General expenses due or accrued	68,721.95
Taxes, license and fees due or accrued "excl. Federal Income Taxes"	5,096.84
Federal Income Taxes due or accrued	21,787.70
Mandatory securities valuation reserve	32,813.06
Total Liabilities	$2,284,939.08
Capital paid-up	$100,000.00
Unassigned surplus	4,205,351.70
Total capital and surplus	4,305,351.70
Total liabilities, capital and surplus	$6,590,290.78

Summary of Operations

Premiums and annuity considerations:	
Life	$3,333,346.39
Accident and Health	3,514,640.59
Net investment income	139,370.52
Total	$6,987,357.50
Deduct:	
Death benefits	$1,365,626.63
Group conversions	1,495.00
Benefits under accident and health policies	2,101,488.52
Increase in reserve for policies and contracts with life contingencies	73,319.00
Increase in aggregate reserve for accident and health policies	20,333.80
Subtotal	$3,562,262.95
Commissions on premiums	786,750.91
General insurance expenses	223,906.84
Insurance taxes, licenses and fees "excl. Fed. Inc. Tax"	13,223.71
Total	$4,586,144.41
Net gain from operations before div. to policyholders and Fed. Inc. Tax	$2,401,213.09

Div. to life policyholders	$721,942.51
Div. on accident and health policies	153,912.86
Total	$875,855.37
Net gain from operations before Federal Income Taxes	$1,525,357.72
Federal Income Taxes incurred	377,217.70
NET GAIN FROM OPERATIONS	$1,148,140.02

Surplus Account

Unassigned surplus December 31, 1963	$3,073,910.96
Net gain	1,148,140.02
Surplus paid in	32,079.25
Total	$4,254,130.23
Net Capital Lossess	$32,079.25
Net loss from non-admitted items	2,203.93
Increase in Mandatory Securities Valuation reserve	14,435.35
Unassigned surplus Dec. 31, 1964	4,205,351.70
Total	$4,254,130.23

Premiums and Annuity Considerations Gross Less Reinsurance Ceded

Renewal:	*Total*
Uncollected	$400,711.50
Deferred	979,300.00
Collected during year	6,148,353.30
Less previous year	671,377.82
Total Premiums	$6,847,986.98
Commissions incurred:	
Renewal	$786,750.91
Total	$786,750.91
Net investment income:	
Gross investment income	$153,461.43
Investment expenses	14,090.91
Net investment income	$139,370.52
Ratio of net investment income to means assets	2.50%

Gross Investment Income

	Collected during year	Due and accrued 12/31/64	Due and accrued 12/31/63	Earned during year
Interest on bonds	[1] $118,349.88	$39,599.67	$14,905.32	$143,044.23
Dividends on stock	10,148.61	0	0	10,148.61
Interest on bank deposits	826.64	0	558.05	268.59
Totals	$129,325.13	$39,599.67	$15,463.37	$153,461.43

[1] Includes $7,547.32 accrual of discount less $39.34 amortization of premium and less $4,035.56 paid for accrued interest of purchases.

Capital Gains and Losses on Investments

	Net loss from change in diff. between book and admitted values	Net losses
Stocks	$32,079.25	$32,079.25
Totals	$32,079.25	$32,079.25
Less federal income tax incurred on capital gains		0
Net unrealized capital losses		$32,079.25

General Expenses

	Insurance			
	Life	Accident and health	Investment	Total
Rent	$2,531.70	$2,288.30		$5,820.00
Salaries and wages	33,037.31	42,910.53		75,947.84
Fees of public accountants	728.62	946.38		1,675.00
Traveling expenses	481.26	625.09		1,106.35
Postage, express, tele., and telegraph	1,382.99	1,796.29		3,179.28
Printing and stationery	1,742.87	2,261.14		4,002.01
Cost of dep. of furniture and equipment	865.11	1,122.65		1,988.76
Books and periodicals	232.70	302.24		534.94
Bureau and association dues	62.86	81.64		144.50
Sundry general expenses	51.26	66.50		117.86

General Expenses—Continued

	Insurance			
	Life	Accident and health	Investment	Total
Gp. services and admin. fees	39,481.30	35,784.86		75,266.16
Donations	180.52	234.48		415.00
Entertainment expense	327.60	425.51		753.11
Transfer to investment expense	(6,129.55)	(7,961.36)	$14,090.91	
General expenses paid	$74,974.55	$81,855.34	$14,090.91	$170,950.80
Gen. exp. unpaid 12-31-64	15,875.00	52,846.95	0	68,721.95
Gen. exp. unpaid 12-31-63	797.13	877.87	0	1,675.00
Gen. exp. incurred during year	$90,052.42	$133,854.42	$14,090.91	$237,997.75

Taxes, Licenses and Fees

	Insurance		
	Life	Accident and health	Total
Ins. Dept. licenses and fees	$2,898.29	$3,764.44	$6,662.73
Other state taxes	164.60	213.78	378.38
U.S. Social Security taxes	512.57	665.76	1,178.33
All other taxes	38.28	49.71	87.99
Taxes, licenses and fees paid	$3,613.74	$4,693.69	$8,307.43
Taxes, lic. and fees unpaid 12-31-64	2,038.74	3,058.10	5,096.84
Taxes, lic. and fees unpaid 12-31-63	85.93	94.63	180.56
Taxes, licenses and fees incurred	$5,566.55	$7,657.16	$13,223.71

Dividends to Policyholders

	Life	Acc. and health
Paid in cash	$482,642.51	$129,512.86
Prov. for dividends payable in following year. Not yet apportioned	239,300.00	24,400.00
Total dividends to policyholders	$721,942.51	$153,912.86

Reconciliation of Ledger Assets

Increase in ledger assets:		
Premiums on life policies		$2,965,045.43
Accident and health premiums		3,183,307.87
Gross investment income		129,325.13
Surplus paid in		32,079.25
Total Increase		$6,309,757.68
Decrease in ledger assets:		
Policy and contract claims:		
Life	$1,191,805.16	
Accident and health	1,694,810.95	
Group conversions	1,495.00	
Dividends to policyholders:		
Life	482,642.51	
Accident and health	129,512.86	
Total Paid Policyholders		$3,500,266.48
Commission to agents		
Life	$390,707.37	
Accident and health	486,312.59	877,019.96
General expenses		170,950.80
Tax, licenses & fees (excl. Fed Income Tax)		8,307.43
Federal Income Taxes		534,786.02
Total Decrease		$5,091,330.69
Reconciliation between years:		
Ledger assets December 31, 1963		$4,002,876.41
Increase in ledger assets during year		1,218,426.99
Total: Ledger assets December 31, 1964		$5,221,303.40

Assets

	Ledger Assets	Non-ledger Assets	Not Admitted Assets	Net Admitted Assets
Bonds	$4,087,581.71			$4,087,581.71
Stocks	162,079.25		$32,079.25	130,000.00
Cash and bank deposits	362,097.90			362,097.90
Reinsurance premiums receivable		$1,371,011.50		1,371,011.50
Furniture and equipment	9,544.54		9,544.44	0
Interest due and accrued		39,599.67		39,599.67
Totals	$5,221,303.40	$1,410,611.17	$41,623.79	$6,500,290.78

Analysis of Non-Admitted Assets

	12/31/63	12/31/64	Change for the year
Furniture and equipment	$7,280.61	$9,544.54	−$2,263.93
Total change			−$2,263.93

ASSETS

Bonds, $4,687,581.71

Bonds owned by the Company as of December 31, 1964, having a book value as shown above, represented 71.1% of the total admitted assets. Government bonds with a par value totaling $606,000.00 were on deposit with the Missouri Division of Insurance and were verified by direct correspondence. Additional government bonds owned by the Company at December 31, 1964, with a par value totaling $1,850,000.00 were verified through the inspection of an official certificate of deposit approved by your Division on September 7, 1965. The remainder of the Company's bonds consisting of Treasury bills maturing in 1965 were verified by checking and inspecting applicable records of cash receipts including bank deposit slips.

Each bond was eligible for amortization, and the scientific method was used in computing the amortization of premiums and the accrual of discount. The Company's computations were found to be accurate. Adjustments for amortization were made annually to the general ledger control account for bonds.

The following schedule classifies the Company's investment in bonds as of December 31, 1964:

	Cost	Par Value	Book and/or Amort. Value
U.S. Government			
Treasury bonds	$2,409,398.46	$2,450,000.00	$2,429,577.04
Treasury bills	2,252,004.67	2,300,000.00	2,252,004.67
Savings bonds	6,000.00	6,000.00	6,000.00
Total	$4,667,403.13	$4,756,000.00	$4,687,581.71

The following reconciliation summarizes the Company's bond transactions for the period from October 1, 1961, through December 31, 1964:

	10-1-61 through 12-31-61	1962	1963	1964
Bk. Val. Beginning of year	$844,966.90	$1,132,770.69	$1,776,484.72	$2,827,346.45
ADD:				
Cost of bonds acquired	430,851.57	1,331,477.31	3,174,938.47	5,956,551.56
Profit on sales	0	0	0	0
Increase by adjustment	7,285.70	12,579.45	8,626.66	7,547.32
Subtotal	$1,283,104.17	$2,476,827.45	$4,960,049.87	$8,791,445.33
DEDUCT:				
Consideration on sales	150,000.00	700,000.00	2,132,348.58	4,103,824.28
Loss on sales	0	0	0	0
Decrease by adjustment	333.48	342.78	354.84	39.34
Book Value End of Year	$1,132,770.69	$1,776,484.72	$2,827,346.45	$4,687,581.71

Accrued interest on bonds as of December 31, 1964, as computed by the Company and verified during the course of this examination was $39,599.67 which amount has been included among the non-ledger assets on the balance sheet of this report. Interest received was tested and found to be correct as reported.

Acquisitions and disposals of bonds were checked through the accounting system into source records, and no discrepancies were noted. All investments were approved at the annual meetings of the shareholders.

The rate of earnings on bonds based on the mean book value is set out in the following exhibit:

Mean book value	$988,868.80	$1,454,627.71	$2,301,915.54	$3,757,464.08
Interest earned	30,438.68	56,063.50	80,435.43	142,044.23
Rate of earnings	3.078%	3.854%	3.494%	3.8335%

Stocks, $130,000.00

The captioned amount represents the Company's investment in 13 savings and loan associations in the amount of $10,000.00 each as of December 31, 1964. Verification was accomplished by direct correspondence with the savings and loan associations. Dividends received for the period under

review were checked comprehensively and were found to be correct as reported on the annual statements.

In addition to the above captioned amount, the Company had common stocks of various subsidiary Aetna Finance Companies in its portfolio as of the examination date. These stocks were contributed to the Company by the ITT Aetna Finance Company, assigned an arbitrary value of $1.00 per share for a total book value of $32,079.25 but also shown as an asset not admitted in the same amount thereby refraining from taking any credit as an admitted asset on the annual statement. This identical treatment has been followed for this report because the stocks are not listed in the N.A.I.C. *Valuation of Securities as of December 31, 1964* and appear to represent minority holdings of stocks not publicly traded.

The following reconciliation summarizes the Company's transactions in stocks and savings and loan shares for the period from October 1, 1961, through December 31, 1964:

	10-1-61 through 12-31-61	1962	1963	1964
Book Value Beginning of period	$0	$0	$0	$500,000.00
Add:				
Cost of stocks acquired	0	0	1,000,000.00	32,709.25
Profit on sales	0	0	0	0
Increase by adjustment	0	0	0	0
Sub-Total	$0	$0	$1,000,000.00	$532,709.25
Deduct:				
Considerations on sales	0	0	500,000.00	370,000.00
Loss on sales	0	0	0	0
Decrease by adjustment	0	0	0	0
Book Value End of Period	$0	$0	$500,000.00	$162,709.25

The rate of earnings based on the monthly mean book value is shown in the following exhibit:

	10-1-61 through 12-31-61	1962	1963	1964
Mean book value	$0	$0	$250,000.00	$205,833.00
Dividends received	0	0	34,457.04	10,148.61
Rate of earnings	0	0	4.864%	4.934%

Cash and Bank Deposits, $362,097.70

At December 31, 1964, the Company had deposits in 7 banks and trust companies aggregating the above amount.

Certificates of deposits were obtained from each depository certified to by an official of each, and reconciled to the Company's general ledger after allowing for outstanding checks and deposits in transit as of December 31, 1964.

Interest received in the amount of $826.64 as reported by the Company at December 31, 1964, was found to be correct.

Reinsurance Premiums Receivable, $1,371,011.50

This non-ledger asset comprising 20.8% of the total admitted assets, represents the net premiums due from ceding insurance companies as of December 31, 1964, and is classified as follows:

	Life	A&H	Total
Due Nov. 30, 1964	$14,026.31	$16,786.03	$30,812.34
Due Dec. 31, 1964	715,225.96	624,973.20	1,340,199.16
Total	$729,252.27	$641,759.23	$1,371,011.50

Monthly reports from the ceding insurance Companies showing the net premiums due were reconciled to the premium receipts from these Companies received in 1965 and were verified correct as reported.

Interest Income Due and Accrued, $39,599.67

The item comprising this amount representing interest due on bonds is commented upon in the prior section of this report.

LEDGER ASSETS NOT ADMITTED

Furniture and Equipment, $9,544.54

Expenditures for furniture and equipment were traced and checked to paid invoices for the period under review. No errors were noted.

LIABILITIES

Aggregate Reserve for Life Policies, $306,698.00

The valuation standard for the above capitioned life reserves was: 1941 CSO 2% NL.

A certification of the Company's reserves was obtained from its consulting actuaries. A copy of the certification has been included as an attachment to this report.

Aggregate Reserve for Accident and Health Policies, $59,673.48

The captioned amount includes the unearned premium reserve of $39,673.48 for group accident and health, computed by the rule of 78 and a provision of $20,000.00 for present value of amounts not yet due on claims. The certification by the consulting actuaries has been reproduced and attached to this report.

Policy and Contract Claims, $902,602.85

Life	*$300,309.20*
Accident and Health	*$602,293.65*

The above amount represents the total liability for benefits under policies determined by this examination and is classified as follows:

	In Course Of Settlement	Incurred but Not Reported	Total
Life	$243,048.26	$57,260.94	$300,309.20
Accident and Health	455,954.58	146,339.07	602,293.65
Total	$699,002.84	$203,600.01	$902,602.85

As stated in the forepart of this report, the Company assumes all of its group and individual life and accident and health insurance in accordance with the terms of the reinsurance contracts involved. Compensation for all life and

accident and health claims to the insured is paid by the ceding Companies for benefits provided for as shown in the policies issued to the insured. Monthly reports furnished by the ceding companies showing the amount of claims paid by them and the monetary amount due them were examined and found to be in accordance with the terms of their respective reinsurance contracts.

All ceding companies submit monthly reports of claims due them with the exception of the Equitable Life Assurance Society of the United States, New York, New York, which submits an annual report as of July 31st of each year for the monetary amount of the settlement according to the reinsurance agreement. In addition, for annual statement purposes, the Equitable Life Assurance Society submits to the Company a report of the Company's share of the claim liability for both life and accident and health claims, as of December 31, 1964. The entire amount shown by Equitable is reported as in course of settlement, on their statement to the Company aggregating $207,000.00 for life claims and $448,473.65 for accident and health claims, and is reported as such in the financial statement of this report.

The liability for incurred but not reported claims as reported by the Company and as determined by this examination as of December 31, 1964, is reflected as follows:

	Per Company 12/31/64	Per Examination 12/31/64	Diff Per Examination
Life:			
Individual	$66,013.47	$57,260.94	−$8,752.53
Group	0	0	0
Accident and Health:			
Individual	56,479.86	101,080.75	+44,600.89
Group Maj. Med.	45,258.32	45,258.32	0
	$167,751.65	$203,600.01	+$35,848.36

The amount shown by the Company at December 31, 1964, was arrived at by the use of a formula, based on past experience taking the claim payments for the first 15 days of January, 1965, and multiplying this amount by 3, plus an additional 10% of the developed amount for accident and

health claims. Your examiners, however, increased this liability in the net amount of $35,848.36 by using the actual amount of claims paid for the period of January 1 through August 31, 1965, on claims incurred during 1964 and not reported until 1965.

No claim files were available for review as all claims are processed, settled and/or closed by the ceding companies. Paid claim vouchers of the Company were reconciled to monthly reports of claims due from the ceding insurance companies involved to determine the amount of claims paid. No errors were noted.

The liability for the incurred but unreported claims on group major medical insurance was developed by a formula, promulgated by Nelson and Warren, Inc., consulting actuaries for the Company, which was considered adequate for the settlement of any and all claims that might occur under these policies.

Provision for Policyholders' Dividends Payable in Following Calendar Year, $263,700.00

The captioned liability was taken from the statement furnished to the Company by the Equitable Life Assurance Society of the United States, New York, New York. The statement covered experience from August 1, 1964, to December 31, 1964, and pertained to dividends for group insurance on employees of the International Telephone and Telegraph Corporation. The dividends are classified as follows:

Life	$221,600.00
AD and D	17,700.00
Weekly Indemnity	1,400.00
Hospital	23,000.00
Total	$263,700.00

Commissions to Agents Due or Accrued, $123,845.20

The above amount, as reported by the Company at December 31, 1964, was verified correct from reports furnished by ceding Companies showing the amount of commissions due them in accordance with their reinsurance contracts.

General Expenses Due or Accrued, $68,721.95

The major portion of the captioned liability represents $66,525.00 comprised of group administration fees accrued

on the group business reinsured from the Equitable Life Assurance Society of the United States as reported on Equitable's year end statement to the Company. The remainder of the liability is comprised of actuarial fees and other expenses of a general nature incurred in 1964 and paid in 1965 with verification achieved by inspection of records of cash disbursements.

The group administration fees were classified according to lines of business as follows:

Life	$12,600.00
AD and D	3,175.00
Weekly indemnity	1,400.00
Hospital	49,350.00
Total	$66,525.00

Taxes, Licenses and Fees Due or Accrued, $5,096.84

The above liability consisted of the following items due and unpaid at December 31, 1964:

Premium taxes	$2,615.22
Occupational taxes	1,176.50
License fees	580.00
New business forms	725.12
Total	$5,096.84

All other liabilities that normally appear under this account were disposed of due to the method of accounting whereby the books are left open for several days at the year end so that many incurred items may be accounted for without the necessity of accruals. The capitioned liability was established through the inspection of a reinsurance report of the Pilot Life Insurance Company which report reflected the items described above and pertained to 1964 business assumed by the Company.

Federal Income Taxes Due or Accrued, $21,787.70

The Federal Income Tax return for the year ending December 31, 1964, together with the canceled check payable to the Internal Revenue department substantiated the above liability.

Mandatory Securities Valuation Reserve, $32,813.06

In accordance with the various resolutions passed by the National Association of Insurance Commissioners, the Com-

pany includes among its liabilities the "Mandatory Securities Valuation Reserve" computed by formula promulgated by the Committee on Valuation of Securities. The Company's computations were checked for each of the years under review and found to be correct as reported.

Capital Stock, $100,000.00

As of December 31, 1964, the Company's authorized and outstanding capital stock amounted to $100,000.00 consisting of 100,000 shares with a par value of $1.00 each and owned in its entirety by the ITT Aetna Finance Company. The capital stock was increased during the course of the examination to $1,000,000.00 consisting of 1,000,000 shares paid for by transfer of $900,000.00 from unassigned surplus to the capital stock account.

ACKNOWLEDGMENT

The assistance and cooperation of the officers and employees of the Company during the course of this examination is hereby acknowledged.

In addition to the undersigned, the following examiners of the Missouri Division of Insurance participated in the examination and in the preparation of this report: Dennis L. Knipp, Don G. Cowsert.

Respectfully submitted,

(Signed) Preston D. Allison

PRESTON D. ALLISON,

Examiner, Division of Insurance, State of Missouri.

NELSON AND WARREN, INC.,
CONSULTING ACTUARIES,
SAINT LOUIS, MO., *September 17, 1965.*

MR. PRESTON D. ALLISON: As Consulting Actuaries who aided in the preparation of the December 31, 1964 Financial Statement of American Universal Life Insurance Company, we affirm that we determined the policy reserves listed below, and that the amounts thereof were computed in accordance with the terms of the outstanding policies and the Insurance Code of the State of Missouri, and that, based upon the records of the Company furnished to us, they are

a true statement of the reserve liabilities of the Company as of December 31, 1964.

1. Aggregate reserve for life policies	$806,698.00
2. Aggregate reserve for A. & H. policies	59,673.48

NELSON AND WARREN, INC.,
By E. DEAN FORBES, (sgd)

St. Louis, Missouri.

ANALYSIS OF CHANGE IN SURPLUS

The unassigned surplus as developed by this examination is $41,062.15 less than reported in the Company's 1964 Annual Statement.

An analysis of this difference is reflected in the folowing schedule.

	Change in surplus		
	Increase	Decrease	
Assets			
No change	$0	$0	
Liabilities			
Policy and contract claims			
Life	8,752.53		
Accident & Health		44,600.89	
General expenses due or accrued		116.95	
Taxes, Lic. & Fees due or accrued		5,096.84	
Totals	$8,752.53	$49,814.68	$41,062.15
Unassigned surplus per Examination December 31, 1964			4,246,413.85
Unassigned surplus per Examination December 31, 1964			$4,205,351.70

EXHIBIT 25

REPORT OF EXAMINATION

ITT HAMILTON LIFE INSURANCE COMPANY

Clayton, Missouri, December 31, 1968

REPORT OF EXAMINATION

ITT HAMILTON LIFE INSURANCE COMPANY

Clayton, Missouri, December 31, 1968

Under Authority of National Association of Insurance Commissioners

States Participating: California, Maryland, Missouri, and Wyoming

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St. Louis, Missouri, June 20, 1969.

Honorable ELMER V. OMHOLT
Commissioner of Insurance
Chairman of Committee on Examinations, N.A.I.C.
Chairman, Zone 6, N.A.I.C.
Helena, Montana 59601

Honorable ROBERT A. SHORT
Insurance Commissioner
Chairman, Zone 2, N.A.I.C.
Dover, Delaware 19901

Honorable WILLIAM Y. MCCASKILL
Superintendent of Insurance
Chairman, Zone 3, N.A.I.C.
Jefferson City, Missouri 65101

Honorable BENJAMIN C. NEFF, Jr.
Director of Insurance
Chairman, Zone 5, N.A.I.C.
Lincoln, Nebraska 68509

SIRS: Pursuant to the requirement of statute and in conformity with your several certificates of authority, an examination has been made of the financial condition, affairs and management of the ITT HAMILTON LIFE INSURANCE COMPANY at its Home Office situated at 212 South Central Avenue, St. Louis, Missouri, 63105. This examination which commenced March 10, 1969, was completed on the above captioned date of this report, which is herewith respectfully submitted.

SCOPE OF EXAMINATION

The examination of the ITT Hamilton Life Insurance Company, hereinafter referred to as such or as the "Company" was conducted by the Missouri Division of Insurance under the plan adopted by the National Association of Insurance Commissioners with participation by examiners from the States of Maryland, Wyoming and California representing Zones II, V, and VI respectively. The last examination of the Company was made by the Missouri Division of Insurance as of December 31, 1964, and the cur-

rent examination covers the intervening period to the close of business on December 31, 1968.

The examination was made in accordance with generally accepted standards, during the course of which, the transactions of the Company were reviewed and tested by methods deemed adequate and appropriate, including a review of general operations, treatment of policyholders, investment policy and financial condition.

Explanation of and details pertaining to the various phases of the examination will be found under the subjects hereinafter set forth.

HISTORY—OBJECTS—GROWTH

History

The company, incorporated under the laws of Missouri on August 8, 1955, as a stipulated premium company, was licensed September 22, 1955 and commenced business October 1, 1955 under the name American Universal Life Insurance Company. The company changed its name to ITT Life Insurance Company on October 3, 1966 and subsequently changed its name to ITT Hamilton Life Insurance Company on August 24, 1967. Initial resources of $50,000 (capital $25,000 and surplus $25,000) were provided through the sale of 100 shares of common stock, par value $250, at $500 per share. On September 6, 1957, the company was converted from a stipulated premium company to a legal reserve life company.

As part of the reorganization, the authorized capital stock was increased to $100,000, comprising 100,000 shares of common stock, par value $1. Each of the outstanding shares, par value $250, was exchanged for 1,000 shares of the new $1 par value stock. A stock dividend of $900,000 (900%) in September, 1965 raised capital to $1,000,000. In January, 1966, a contribution surplus of $2,080,349 was made which comprised all the outstanding stock of the Alexander Hamilton Life Insurance Company, Denver, Colorado. At year end 1967, Alexander Hamilton Life was

absorbed by merger. Present authorized capital is 1,000,000 shares of common stock, par value $1, all of which are issued and outstanding.

In December, 1967, the Company purchased control of Modern Life Insurance Company, New York, and at 1967 year end owned about 98% of the shares of Modern Life, which changed its name to ITT Life Insurance Company of New York on April 1, 1968.

Documents as regards the increase of capital stock from $100,000 to $1,000,000 on September 7, 1965; the change in name to ITT Life Insurance Company on October 3, 1966, and the subsequent change to ITT Hamilton Life Insurance Company on August 24, 1967, were submitted to and received approval of the Secretary of State as well as the Superintendent of Insurance of Missouri, as required by statutes.

The contribution to the Company's surplus of $2,080,349 representing all of the outstanding capital stock of the Alexander Hamilton Life Insurance Company, was approved by the Superintendent of Insurance of Missouri in accordance with Section 375.355 of the Missouri Insurance Statutes relating to "Acquisition of control of one company by another." Prior to the contribution this stock was held in the name of the ITT Aetna Finance Company, a Delaware corporation.

In the merger of the Alexander Hamilton Life Insurance Company, a Delaware corporation, with Administrative Offices in Denver, Colorado, the assets received and the liabilities assumed by the Company were as follows:

	Assets received	Liabilities assumed	
Bonds	$528, 499	$1, 050, 626	Life reserves
Stocks	232, 964	3, 379	A & H reserves
Mortgage loans	62, 877	38, 611	Life claims
Policy loans	1, 185	82	A & H claims
Cash & bank deposits	1, 818, 803	6, 392	Prems. paid in advance
Due from reinsurers	12, 377	4, 266	Prem. deposit funds
Uncoll. & Def. life prems.	449, 214	26, 453	Commissions to agents
A & H prems. due & unpaid.	(88)	32, 487	Unpaid expenses

	Assets received	Liabilities assumed	
Inv. income due & accrued.	$28, 908	$36, 670	Taxes, licenses & fees
		2, 547	Amts. held for others
		5, 039	Remitts. not allocated
		1, 917	Mandatory security val. res.
		1, 926, 270	Assets in excess of liabilities
Totals	$3, 134, 739	$3, 134, 739	

Assets in excess of liabilities to the extent of $1,926,270 represents the book value (capital plus surplus) of the Alexander Hamilton Life Insurance Company, Denver, Colorado, at December 31, 1967, which at the time it was contributed in January 1966, was worth $2,080,349.

As required by Section 376.520 of the Missouri Insurance Statutes, the merger was approved by a three-way commission consisting of the insurance supervisory authorities of the States of Illinois, Missouri and Ohio. In addition a "certificate of assumption" was mailed to each policyholder of the Alexander Hamilton Life Insurance Company at the time the merger was completed.

Objects

The principal purposes for which the Company was formed as set out in its amended Articles of Incorporation, are as follows:

> "To make insurance upon the lives of individuals and every assurance pertaining thereto or connected therewith; to grant, purchase, and dispose of annuities and endowments of every kind and description whatsoever; to provide for contracts of indemnity against death and for weekly and other periodic indemnities for disability occasioned by accident or sickness to the person of the insured, and such accident and health insurance shall be made a separate department of the business of the corporation, and for the reinsurance of any of the foregoing;

and to do such other things as may be permitted a corporation of this kind by law, and not prohibited by the 1949 Revised Statutes of Missouri, Sections 376.010 to 376.670, both inclusive, as amended. The corporation may issue participating and non-participating policies or contracts, provided that any participating policy or contract shall give the right to participate in the divisible surplus earnings of the company as provided by law and more particularly as provided by Sections 376.360 and 376.370 of the 1949 Revised Statutes of Missouri, as amended."

Growth

Following is a schedule, in condensed form, setting forth pertinent data respecting the Company's trend from operations during the period under examination:

Year	Life insurance in force	A&H premiums written	Capital paid-up	Admitted assets	Surplus as regards policyholders
1964.....	$221,383,507	$3,183,308	$100,000	$6,590,201	$4,246,414
1965.....	253,814,053	4,099,259	1,000,000	13,720,593	4,220,593
1966.....	309,210,582	4,850,877	1,000,000	15,855,639	7,537,375
1967.....	474,348,889	6,080,775	1,000,000	15,112,657	4,588,451
1968.....	749,087,417	8,021,746	1,000,000	19,550,833	5,417,535

The sharp decrease in surplus as regards policyholders during 1967 of $2,948,924, can be attributed chiefly to the Company's purchase of over 95% of the capital stock of the Modern Life Insurance Company of New York, later renamed ITT Life Insurance Company of New York, which was acquired at a cost of $5,309,991. This stock had to be valued at book (Capital plus surplus) amounting to $1,704,479, as prescribed in Section 4, Procedures for valuing other securities, of the N.A.I.C. Book of Valuations of Securities, which accounts for large unrealized capital loss effecting surplus during 1967.

The purchase of the aforedescribed stock received the approval of the Superintendent of Insurance of Missouri, as required by Section 375.355 of the Missouri Insurance Statutes relating to "Acquisition of control of one company by another." A quarterly financial statement of the Modern Life Insurance Company as of June 30, 1967, filed with the

Superintendent of the New York Insurance Department was presented at this hearing.

As respects the purchase of the capital stock of the Modern Life Insurance Company of New York, the Company was required to execute a "Commitment Agreement" with the New York Insurance Department. Generally, under the terms of this agreement there can be no inter-locking transactions between the companies without the approval of the New York Insurance Department and the ITT Life Insurance Company of New York agrees to operate at arm's length in relation to the ITT Hamilton Life Insurance Company, its subsidiaries and affiliates.

At the time of the aforementioned purchase all of the outstanding capital stock of the Company was registered in the name of the ITT Aetna Corporation of New York.

MANAGEMENT

The Company is wholly owned by ITT Aetna Corporation, a New York corporation which, in turn, is a subsidiary of the International Telephone and Telegraph Corporation of New York.

Operations are conducted on the proprietary plan and academically the Company's corporate powers are vested in and exercised by a Board of Directors, consisting of twelve members, elected annually by the stockholders. Following each annual meeting of stockholders, the Directors convene for the purposes of organization and the appointment of officers and committee members who, according to the by-laws, are charged with the active management of the Company's affairs.

Directors, committee members and officers duly elected and serving December 31, 1968, were as follows:

Board of Directors

Name	Principal Business Affiliations	Residence
Joseph Kutten	Board Chairman and Chief Executive Officer of the Company.	Ladue, Mo.
Howard T. Cohn	Vice President and Actuary of the Company and Vice President of the ITT Financial Services Inc.	Madison, N.J.

Board of Directors—Continued

Name	Principal Business Affiliations	Residence
David R. Corwin	President, ITT Aetna Corporation	Chesterfield, Mo.
Gerhardt M. Hoff	Director of Insurance Operations of ITT Financial Services Inc.	New York, N.Y.
Dean L. Hones	Vice President of the Company	Littleton, Colo.
Gerald M. Kantor	Vice President and Treasurer of the Company.	St. Louis County, Mo.
John H. Kostmayer	Director, ITT Financial Services Inc.	Solebury, Pa.
Claude J. Peay	Vice President of the Company and Vice President, Hamilton Management Corporation.	Denver, Colo.
Frank H. Peirson	President of the Company and President of Hamilton Management Corporation.	Englewood, Colo.
Robert B. Schneider	Secretary of the Company	St. Louis, Mo.
James C. Swain	Senior Vice President of the Company and Vice President of the Hamilton Management Corporation.	Arvada, Colo.
Joseph R. Tirone	Vice President of the Company and Vice President & Comptroller of Hamilton Management Corporation.	Denver, Colo.

EXECUTIVE COMMITTEE

Howard T. Cohn
David R. Corwin
Gerhardt M. Hoff
Joseph Kutten
Frank H. Peirson
James C. Swain

John H. Kostmayer, Acting Chairman

Officers

Name	Title	Annual compensation (1968)
Joseph Kutten	Board Chairman and Chief Executive Officer	$45,000
Frank H. Peirson	President	0
James C. Swain	Senior Vice President	0

Officers—Continued

Name	Title	Annual compensation (1968)
Howard T. Cohn	Vice President & Actuary	0
Dean L. Hones	Vice President	0
Gerald M. Kantor	Vice President & Treasurer	$19, 800
Claude J. Peay	Vice President	0
Warren J. Schulte	Vice President	17, 100
Joseph R. Tirone	Vice President	0
Robert B. Schneider	Secretary	17, 200

The Company states that officers to which no compensation was paid during the year 1968, were remunerated directly by the International Telephone and Telegraph Company, its subsidiaries or affiliates.

Aside from actual expenses incurred, no officers or member of the Board of Directors, salaried or otherwise, receive a fee for actual attendance of this corporate body.

Annual meetings of stockholders as well as the Board of Directors are held on the second Tuesday in March of each year. Special meetings are upon call by one-fifth (1/5) or more of the outstanding stock in the case of shareholders and a majority of the members are necessary at any meeting of the Board of Directors.

Signed minutes of the meetings of all corporate bodies held during the period under examination were reviewed. These records indicate good attendance and the shares of stocks represented by the parent company were always voted en bloc by a duly authorized attorney-in-fact.

There were a number of changes made in the Articles of Incorporation and By-laws during the period under review. The most important of these, which are not commented upon elsewhere in this report was the increase in the Board of Directors from nine (9) to twelve (12) members.

To guard against any conflict of interest the Company requires its Officers and Directors to execute a signed statement containing the following quoted questions:

> 1. Do you or does any member of your family have any relationships or engage in any activities that

might impair your independence of judgment concerning Company business?

2. Do you or does any member of your family have any personal financial interests that might impair your independence or judgment or influence your decisions or actions concerning Company business in the direction of such personal financial interests?

3. Have you accepted gifts, benefits, or unusual hospitality that might tend in any way to impair your independence of judgment or affect your decisions or actions concerning Company business?

(If your answer to any of the foregoing three questions is "yes", please attach to this questionnaire a full explanation.)

Officials stated they have no record in the history of the Company of any of its members having been involved in a conflict of interest case.

The business affairs of the Company's Denver, Colorado office are administered under the terms of a management contract. Further explanation concerning this are contained in "General Comments", appearing in the concluding pages of this report.

FIDELITY BONDS AND OTHER INSURANCE

The Company is a named assured in a number of policies issued to its parent Company, International Telephone and Telegraph Corporation of New York, affording protection as follows:

Comprehensive General—Automobile Liability Insurance, Limit of Liability—Combined Single Limit, $2,000,000.00 "Each Accident"

A—Bodily Injury Liability—Automobile (Owned-Non-Owned) Property Damage Liability

B—Bodily Injury Liability—Except Automobile Property Injury Liability—Except Automobile

C—Personal Injury Liability

D—Malpractice—Physicians and Nurses employed by the insured

E—Assault and Battery

In addition the above policy also provides the following Coverages:

1—Products Liability—Aircraft Products
2—Private Heliport
3—Contractual Liability Coverage
4—Airport Liability
5—Personal Liability Coverage for Executive Officers (Limit $200,000.00 Liability and $250.00 Medical and is applicable only outside of United States, its Territories, Possessions, and Canada)

Blanket Crime Policy:

Liability $2,000,000.00; Deductible $5,000.00
1—Loss of money, securities and other property through fraudulent and dishonest acts of employees
2—Loss Inside Premises Coverage (Banking premises covered)
3—Loss Outside Premises Coverage
4—Money Orders and Counterfeit Paper Currency Coverage (if not paid upon presentation)
5—Depositors Forgery Coverage
6—Credit Card Forgery Coverage—Shall not exceed, in the aggregate, $10,000.00 (Deductible not applicable)

In addition to the above policies ITT Hamilton Life Insurance Company is protected by a "Burglary Policy" covering the Loss of Securities deposited with the First National Bank in St. Louis, St. Louis, Missouri, in the amount of $2,000,000.00.

The foregoing policies were inspected and found to be carried through authorized insurers in Missouri.

EMPLOYEE BENEFIT AND WELFARE PLANS

Group life and hospitalization insurance is provided for the employees of the Company. Under the group life policy, death benefits range from $2,000.00 to $10,000.00. The amount of insurance is determined by the employees' basic annual salary and is approximately one year's salary with an

equal amount for accidental death and dismemberment. The policies are non-contributory as regards the employees, the Company assuming the entire cost. The group hospitalization policy provides benefits for room and board charges, special hospital services and additional medical expenses for surgical bills, doctor bills and related charges. It is a comprehensive medical plan which is non-contributory for employees and contributory in part for dependents.

During the latter part of 1968, provisions were made for the salaried employees of the Company to participate in the International Telephone Retirement Plan. The Company is a wholly-owned subsidiary of International Telephone and Telegraph Corporation. The participation effective retroactively as of January 1, 1968. The cost of providing benefits under the plan is paid entirely by the Company and no contributions are required from the employees. All salaried employees on January 1, 1968 and who were less than age sixty-five on that date automatically became members of the plan as of January 1, 1968. All eligible salaried employees hired after January 1, 1968 who are younger than age fifty-five at date of employment automatically become members when they complete three years of service or reach age thirty, if earlier.

Normal retirement age under the plan is sixty-five. However, an employee can elect to retire on the first day of any month between age fifty-five and sixty-five, provided he has at least ten years of credited service and the Company approves.

The Company's contributions to the plan go into a trust fund managed by a Plan Trustee, according to the terms of a trust agreement. This money is invested by the Trustee and is used to provide benefits for the members and their beneficiaries.

TERRITORY AND PLAN OF OPERATIONS

As of December 31, 1968 the Company was authorized to transact the business of insurance in the District of Columbia, Guam, Puerto Rico, and in all states except Connecticut, New Jersey and New York, as evidenced by Certificates of Authority from the various jurisdictions. With the exception of Missouri, the Company was admitted to do business in

the various jurisdictions during the four year period under examination.

The Company's ordinary operations are conducted on the general agency plan through approximately 2,600 agents, a majority of whom are also representatives of Hamilton Management Corporation (independent sales force distributors of Hamilton Funds, Inc., a mutual fund). The entire ordinary operations are maintained at the Company's Denver, Colorado office.

Group operations including all credit business are conducted at the Company's home office. Group life and accident and health business is generated through seven group sales offices. Credit life and accident health business is written primarily through approximately 260 ITT Aetna Finance offices.

POLICY FORMS AND UNDERWRITING PRACTICES

The Company writes whole life, limited payment life, family income, and level and decreasing term insurance on an individual or on a joint basis. Riders which may be attached to policies include waiver of premium, accidental death and level and decreasing term insurance. The Company also issues group life and group accidental and health policies. Credit life and credit accident and health insurance are written on a group contract in most states.

All of the Company's ordinary business are nonparticipating.

Prior to April 1, 1968, the Company's maximum limit of retention on any one life was $25,000 with a corridor of $10,000 on life insurance, and $10,000 for accidental death benefits. Effective April 1, 1968, the maximum retention was increased to $50,000 with a corridor of $10,000 on life insurance, with the accidental death benefits remaining at $10,000.

The Company's underwriting rules regarding non-medical limits is shown in the following schedule:

Ages:	*Amount*
0 to 5	$20,000
6 to 28	50,000
29 to 35	20,000
36 to 40	10,000

The Company's method of recording approval of its forms by the various states in which it is licensed was reviewed, as well as correspondence with various insurance departments relating to the approval of a sampling of policy forms used by the Company. The method used appears to be adequate.

REINSURANCE

Ceded

At December 31, 1968 the Company had in force two automatic reinsurance agreements covering its ordinary life business with two companies admitted in the State of Missouri. One agreement applies to ordinary business where the insured's last name falls in the range "A to K", and the other agreement applies to ordinary business in the "L to Z" range. Under the agreements the Company agrees to cede and the reinsurers agree to accept ordinary business in excess of the following retention limits:

Age	Standard	Substandard (to table 16)
0 to 80	$50,000	$50,000

(The above may be exceeded by amounts less than $10,000 to avoid reinsurance.) Accidental death (D.I.)—All ages, all tables—$10,000.

The first reinsurer (A to K) automatically accepts up to four times the Company's retention on ages 0 to 60 and twice the Company's retention on ages 61 to 80, and up to $90,000 on accidental death benefit.

The second reinsurer (L to Z) accepts up to four times the Company's retention for all ages, and up to $50,000 on accidental death benefit.

In order to protect itself against excessive losses on group policies, the Company had in effect the following reinsurance agreements: an automatic agreement on group life and accidental death and dismemberment; quota share agreement on group long term disability; and a combination

quota share and first surplus agreement on group accidental death, dismemberment and permanent total disability.

As of December 31, 1968 the Company also had in effect agreements with three authorized companies providing for cession on a facultative basis.

All of the above reinsurance contracts include the customary insolvency clause.

Assumed

In a reinsurance agreement effective October 1, 1968 between the Company and its subsidiary, ITT Life Insurance Company of New York, the Company agrees to indemnify ITT Life of New York at the end of the contract year that portion by which the covered losses (amount of death claims less the reserves thereon) incurred by ITT Life of New York on the covered amount at risk (the average of the life insurance in force less the average of the mean life insurance reserves thereon) exceed 100 per cent of expected mortality according to the 1955–60 Select Basic Mortality Table. ITT Life of New York agrees to pay the Company at the end of the contract year a premium of $100 plus the excess, if any, of the expected covered life insurance mortality over the actual mortality of the covered lives. The maximum covered amount at risk on any one life under the agreement is $57,500.

In an agreement with Equitable Life Assurance Society of the United States, the Company agrees to reinsure a certain portion of the premiums and liabilities under certain group life and accident and health policies issued by Equitable to the International Telephone and Telegraph Corporation.

As of December 31, 1968, the Company had in effect reinsurance agreements with the following companies under which the Company agrees to reinsure 100 per cent of the credit life and credit accident and health insurance written upon the lives of debtors of the subsidiaries of ITT Aetna Corporation located in the following states:

Pilot Life Insurance Company, Maryland and Alabama
Old Republic Life Insurance Company, Pennsylvania
National Fidelity Life Insurance Company, Arizona

SPECIAL AND DEPARTMENTAL DEPOSITS

The deposits of securities as shown in the following schedule were confirmed by certificates and/or certified listings received direct from the respective depositories:

Depository	Accepted deposit value	Amortized value	Market value
Bonds:			
Missouri	$4,028,715	$4,289,921	$3,778,500
Colorado	350,000	349,793	343,000
Delaware	100,000	100,278	92,000
Guam	150,000	122,218	120,000
Total bonds	$4,628,715	$4,862,210	$4,333,500
Stocks: Georgia	$30,000	$0	$30,000

Of the total deposited with the Missouri Insurance Division, bonds with a par value of $300,000 and a market value of $282,000, represent the capital deposit requirement while the remaining deposit is in connection with the policy registration laws of Missouri. The amount of deposit required for net policy reserves on outstanding registered business at December 31, 1968, is $2,171,711.93.

At the time the Company acquired the business of the Alexander Hamilton Life Insurance Company, a Delaware corporation, with administrative offices in Denver, Colorado, the latter had on deposit United States Treasury bonds of an aggregate par value of $350,000.00 with the State Insurance Department of Colorado, and this deposit has been undisturbed ever since.

The remaining deposits with the various jurisdictions are for qualifying purposes.

FINANCIAL STATEMENT

Following is a financial statement of the Company's condition at the close of business December 31, 1968, as determined by this examination, subject to explanatory comments regarding the various items. This statement consists of assets, liabilities, surplus and other funds, together with several re-

lated exhibits, encompassing operations for the one year period ended December 31, 1968.

Assets:	
Bonds	$14,521,847.74
Stocks:	
Preferred	754,108.50
Common	1,534,305.03
Mortgage loans on real estate	220,302.68
Policy loans	4,445.33
Cash and bank deposits	641,184.67
Amounts recoverable from reinsurers	27,000.00
Premiums receivable	989,153.94
Due under co-insurance agreements	30,004.60
Life insurance premiums and annuity considerations deferred and uncollected	630,119.58
Accident and health premiums due and unpaid	702.20
Investment income due and accrued	203,888.22
Funds held by or deposited with ceding reinsurers	47,211.00
Total	$19,604,363.58
Liabilities, surplus and other funds:	
Aggregate reserve for life policies and contracts	$7,788,306.83
Aggregate reserve for accident and health policies	3,103,742.69
Policy and contract claims:	
Life	428,772.57
Accident and Health	352,657.65
Premiums and annuity considerations received in advance	9,193.71
Liability for premium deposit funds	7,911.05
Commissions to agents due or accrued	333,733.41
General expenses due or accrued	83,166.40
Taxes, licenses and fees due or accrued	225,454.73
Federal income taxes due or accrued	1,189,806.63
"Cost of collection" on premiums etc., in excess of loading thereon	107,860.06
Amounts withheld or retained by company as agent or trustee	15,747.88
Remittances and items not allocated	26,045.80
Mandatory securities valuation reserve	38,048.65
Deferred pension benefits	3,500.00
Due to subsidiary	211,287.14
Total Liabilities	$13,925,235.20
Mortality fluctuation reserve	537,200.00
Capital paid-up	1,000,000.00
Gross paid in and contributed surplus	2,580,348.74
Unassigned surplus	1,561,579.64
Total	$19,604,363.58

SUMMARY OF OPERATIONS

(Accrual Basis)

Premiums and annuity considerations—Life	$7,077,995.92
Premiums and annuity considerations—Accident and Health	7,964,206.49
Considerations for supplementary contracts without life contingencies and dividend accumulations	0
Net investment income	1,247,735.57
Other income	384.66
Total	$16,290,322.64
Deduct:	
Death benefits	$2,436,601.84
Annuity benefits	564,979.80
Disability benefits	1,315.54
Surrender benefits	8,627.04
Group conversions	(780.00)
Benefits under accident and health policies	3,739,281.28
Interest on policy or contract funds	223.59
Increase in aggregate reserve for policies and contracts with life contingencies	411,277.86
Increase in reserves for accident and health policies	1,906,316.88
Sub-Total	$9,067,843.83
Commissions on premiums and annuity considerations	1,702,748.51
General insurance expenses	1,391,387.36
Insurance taxes, licenses and fees	298,421.66
Increase in loading on and cost of collection in excess of loading on deferred and uncollected premiums	174,030.71
Total	$12,634,432.07
Net gain from operations before dividends to policyholders and federal income taxes and excluding capital gains and losses	$3,655,890.57
Dividends to life policyholders	$912,657.00
Dividends on accident and health policies	577,054.00
Total	$1,489,711.00
Net gain from operations after dividends to policyholder and federal income taxes and excluding capital gains and losses	$2,166,179.57

SURPLUS ACCOUNT

Gross paid in and contributed surplus, 12-31-67.	$2,580,348.74	Federal income tax due or accrued.	$1,189,806.63
Unassigned surplus, 12-31-67	2,008,102.58	Due to subsidiary	211,287.14
Adjustment on prior yrs., depreciation.	10,274.71	Net capital losses	700,543.01
Funds held or deposited with ceding reinsurers.	47,211.00	Net loss from non-admitted & related items.	48,597.56
Over accrual of income tax	29,942.57	Increase in mandatory securities valuation res.	12,800.43
Net gain	2,166,179.57	Special Surplus funds 12-31-68	537,200.00
Overpayment of income tax	103.98	Gross paid in & contributed surplus 12-31-68.	2,580,348.74
		Unassigned surplus December 31, 1968.	1,561,579.64
Total	$6,842,163.15	Total	$6,842,163.15

RECONCILIATION OF LEADER ASSETS

Increase in Ledger Assets:		
Premiums on life policies and annuity considerations		$6,693,876.77
Accident and health cash premiums		8,021,745.62
Gross investment income		1,217,383.82
Miscellaneous income		488.64
Contribution for employees retirement benefits		3,500.00
Prior years depreciation adjustment		10,274.71
Increase in ledger liabilities during year		68,001.34
From sale or maturity of ledger assets		101,105.85
Total Increase in Ledger Assets		$16,116,376.75
Decrease in Ledger Assets:		
Policy and contract claims—Life	$2,754,735.61	
Policy and contract claims—A&H	3,779,883.62	
Surrender value	8,627.04	
Group conversions	(780.00)	
Interest on policy loans	223.59	
Dividends to policyholders:		
Life and annuities	912,657.00	
Accident and health	557,054.00	$8,032,400.86
Commissions to agents:		
Life and insurance and annuities	$927,937.15	
Accident and health	684,304.91	1,612,242.60
General expenses		1,391,992.72
Taxes, licenses and fees		148,689.93
From sale or maturity of ledger assets		142.64
Total Decreases in Ledger Assets		$11,185,468.21

Reconciliation Between Years:	
Amounts of Ledger Assets December 31, 1967	$17,217,213.57
Increase in Ledger Assets During the Year	4,930,908.54
Total—Ledger Assets December 31, 1968	$22,148,122.11

EXHIBIT 13—ASSETS

	Ledger Assets	Non-Ledger Assets	Assets Not Admitted	Net Admitted Assets
Bonds	$14,521,847.74			$14,521,847.74
Stocks:				
Preferred stocks	754,108.50			754,108.50
Common stocks	5,894,497.32		$4,360,192.29	1,534,305.03
Mortgage loans: First liens	223,177.68		2,875.00	220,302.68
Policy loans	4,445.33			4,445.33
Deposits in banks and trust companies	641,184.67			641,184.67
Premiums receivable		$989,153.94		989,153.94
Amounts recoverable from reinsurers		27,000.00		27,000.00
Agents' balances (debit $4,941.56 credit $0)	4,941.56		4,941.56	
Furniture and equipment	73,824.62		73,824.62	
Due under co-insurance agreement	30,094.69			30,094.69
Life insurance premiums deferred and uncollected (less reinsurance premiums):				
Ordinary deferred and uncollected				
New business (excluding $138,010.31 loading) $133,244.58				
Renewal (excluding $156,181.62 loading) $496,522.24		630,119.58		630,119.58
Group life deferred and uncollected (excluding $910.03 loading) $352.76				
Accident and health premiums due and unpaid		702.20		702.20
Investment income due and accured		203,888.22		203,888.22
Funds held by or deposited with ceding reinsurers		47,211.00		47,211.00
Totals	$22,148,122.11	$1,896,074.94	$4,441,833.47	$19,604,363.58

COMMENTS ON FINANCIAL STATEMENT

Assets

Bonds, $14,521,847.74

Bonds owned by the Company at December 31, 1968, are classified and valued in the following schedule:

Classification	Amortized and Book Value	Par Value	Actual Cost	Market Value
Government: United States	$1,816,969.22	$1,830,000.00	$1,811,357.14	$1,782,863.38
States, Territories and Possessions:				
United States	40,425.48	40,000.00	40,456.80	40,425.48
Canada	590,852.54	598,000.00	588,907.50	590,852.54
Political Subdivision of States, Territories and Possessions: United States	404,573.33	400,000.00	404,043.50	404,573.33
Special Revenue: United States	94,748.12	100,000.00	94,000.00	79,000.00
Railroads: United States	571,956.03	633,248.00	568,736.11	546,179.46
Public Utilities: United States	7,194,548.64	7,277,000.00	7,185,602.73	6,615,117.79
Industrial and Miscellaneous: United States	3,807,774.38	3,846,145.18	3,803,688.17	3,609,793.87
Totals	$14,521,847.74	$14,724,393.18	$14,406,741.95	$13,668,805.85

Bonds are entered on the Company's books at actual cost, and the book values are adjusted each year to record amortization of premium and accrual of discount, computed on basis of effective rate of yield. All bonds were found to be eligible for amortization and none were in default as to principal or interest. A complete check of the Company's computations of accruals of discounts and amortization of premiums on the scientific method for the period under review indicated correctness and subsequent proper entries being made, and the amortized value of bonds owned December 31, 1968 as reported by the Company was accepted without change.

Market values reflected in the foregoing exhibit were calculated in accordance with the resolutions adopted by the Committee on Valuations of Securities of the National Association of Insurance Commissioners. Prices quoted in the manual published by the Committee were used to value all issues for which market prices were available. Private placements, municipals and other unlisted issues were valued at the Company's amortized values at December 31, 1968.

Bonds owned by the Company at December 31, 1968 were accounted for at par value as follows:

	Par Value
Vault: First National Bank In St. Louis, Saint Louis, Missouri	$5,470,000.00
Vault: First National City Bank, New York, New York	3,354,393.18
Deposit: Colorado Insurance Department	350,000.00
Deposit: Delaware Insurance Department	100,000.00
Deposit: Guam Insurance Department	150,000.00
Deposit: Missouri Insurance Department	4,300,000.00

	Par value
Check of accounting records for Treasury Bills that matured in 1969 prior to date of physical inspection	1,000,000.00
Par value of bonds owned December 31, 1968	$14,724,398.18

Bonds in the vault of the First National Bank in St. Louis, Saint Louis, Missouri, were verified by physical inspection and count on April 2, 1969, by the Examiners.

Bonds in the vault of the First National City Bank, New York, New York, were held under a custodial agreement for safe keeping. The custodial agreement was reviewed and found to be in order. The bonds in the custodian's possession were verified by certificate received directly from the custodian.

Bonds on deposit with the Colorado, Delaware, Guam and Missouri Insurance Departments were verified by certificates received directly from the respective custodians.

The activity in the bond account during the period under review was as follows:

Book value at beginning of year		$4,687,581.71
Acquisitions:		
Cost of bonds acquired	$49,308,997.55	
Increase by adjustment [1]	68,105.43	
Profit on sales	5,057.82	
Due to merger Alexander Hamilton Life Insurance Company	528,499.43	49,910,660.23
		$54,598,241.94
Disposals:		
Considerations on sales	$40,041,782.04	
Decrease by adjustments [1]	4,145.14	
Loss on sales	30,467.02	40,076,394.20
Book value December 31, 1968		$14,521,847.74

[1] Amortization of premium and/or accrual of discount.

Acquisitions and disposals of bonds during the period under review were confirmed by a review of vouchers, invoices, bank correspondence, receipts and other data. All investments were approved at the meeting of the Board of Directors.

Bond interest received in the amount of $541,893.55 net of $13,321.13 accrual of discount, $1,943.41 amortization of premiums and $30,508.25, paid for accrued interest on purchases during 1968 was checked in detail. Accrued interest as of

December 31, 1968, as computed by the Company was verified in detail during the course of this examination, and was found to be correct as reported. The amount of $203,618.11, as reported in the Company's Annual Statement, has been included in the financial statement of this report as a non-ledger asset.

Without consideration of reinvestment of interest income or of investment expenses, the following statement reflects bond interest earned as a percentage of the mean book value of bonds for the years covered by this examination:

	1965	1966	1967	1968
Mean book value	$8,141,177.58	$11,910,833.50	$10,505,923.03	$11,653,399.62
Interest earned	$174,297.71	$386,057.60	$534,875.95	$685,330.97
Yield percentage	2.141%	3.241%	5.091%	5.881%

Stocks, $2,288,413.53

The Company's investment in stocks as of December 31, 1968, consisted of 11,250 shares of preferred stock with a cost, book and admitted value of $754,108.50, and 484,464 ¼ shares of common stock with a cost and book value of $5,894,497.32 and a market and admitted value of $1,534,305.03 summarized by classification as follows:

Classification	Number Shares	Cost and Book Value	Admitted Value
Preferred: Public Utilities	11,250	$754,108.50	$754,108.50
Total preferred	11,250	$754,108.50	$754,108.50
Common:			
Public Utilities	2,300	$108,129.69	$91,800.00
Banks, trust and insurance companies	445,591	5,397,005.79	1,077,657.03
Savings and Loan deposits		30,000.00	30,000.00
Industrial and miscellaneous	36,573¼	359,361.84	334,848.00
Total common	484,464¼	$5,894,497.32	$1,534,305.03
Total preferred and common	495,714¼	$6,648,605.82	$2,288,413.53

The foregoing admitted values were established in accordance with appropriate resolutions adopted by the National Association of Insurance Commissioners, such resolutions providing for the methods by which securities shall be valued by insurance companies in preparing Annual Statements.

The Company has elected to value its preferred stocks at cost for statement purposes.

The admitted value for common stocks owned at December 31, 1968, was established from association market values listed in the N.A.I.C. Publication, "Valuation of Securities" as of December 31, 1968, or values determined by methods prescribed in that publication.

The excess of book value over market value of common stocks, in the amount of $4,360,192.29 has been included in the Financial Statement of this report as a not-admitted asset.

In addition to the above captioned amount, the Company owned common stocks of various subsidiary Aetna Finance Companies in its portfolio as of the examination date. These stocks were contributed to the Company by the ITT Aetna Finance Company, assigned an arbitrary value of $1.00 per share for a total book value of $31,865.25 but also shown as an asset not admitted in the same amount thereby refraining from taking any credit as an admitted asset in the Annual Statement. This identical treatment has been followed for this report as these stocks are not listed in the N.A.I.C. Valuations of Securities as of December 31, 1968.

The Company owned 98.7% of the common stock of ITT Life Insurance Company of New York, a New York Corporation. The Company followed the method prescribed by N.A.I.C. publication "Valuations of Securities" in determining the admitted value of this stock as of December 31, 1968.

The Company had on deposit with the Insurance Department of Georgia, $30,000.00 which consisted of three $10,000.00 Savings and Loan Association Investment Ceritficates. This deposit was verified by certification received directly from the custodian.

Stocks in the vault of the First National Bank in St. Louis, Saint Louis, Missouri, were verified by physical inspection and count on April 2, 1969, by the Examiners. All certificates were found to be registered in the Company's name.

Stocks in the vault of the First National City Bank, New York, New York, were held under a custodial agreement for safekeeping. The custodial agreement was reviewed and found to be in order. The stocks in the custodians possession were verified by certificate received directly from the custodian.

The Aetna Finance Company stocks were physically inspected and counted on April 23, 1969, by the Examiners in the Company's office. These stocks are in the name of the Company and during the course of this examination were placed in a safe deposit box in the Saint Louis County National Bank, Clayton, Missouri, for safekeeping.

The following exhibit reflects the activity in the Company's stock account during the period under review.

Book value at beginning of year		$162,079.25
Acquisitions:		
Cost of stocks acquired	$9,036,993.03	
Profit on sales	116,307.20	
Due to merger Alexander Hamilton Life Insurance Company	232,963.55	9,386,263.78
		$9,548,343.03
Disposals:		
Considerations of sales	$619,363.47	
Loss on sales	25.00	
Due to merger Alexander Hamilton Life Insurance Company	2,280,348.74	2,899,737.21
Book Value December 31, 1968		$6,648,605.82

Acquisitions and disposals of stocks during the period under review were confirmed by a review of vouchers, invoices, bank correspondence, receipts and other data. All investments were approved at the meetings of the Board of Directors.

The Company's investment in mortgage loans on real estate at December 31, 1968, amounted to $220,302.68, and are classified as follows:

Class	Number	Unpaid Balance
V.A. Loans	1	$16,659.21
Conventional	4	203,643.47
Totals	5	$220,302.68

The following schedule shows the number and amount of loans owned, distributed by jurisdiction:

Jurisdiction	Number of Loans	Unpaid Balance
Colorado	2	$39,476.27
Missouri	2	161,298.55
Washington	1	19,527.86
Totals	5	$220,302.68

The following schedule shows the number of loans at their specific rates of interest and the unpaid balance as at December 31, 1968:

Number of Loans	Interest Rate	Unpaid Balance
1	5¼%	$16,659.21
2	5½%	42,344.92
1	6%	139,500.00
1	6½%	21,798.55
5	Totals	$220,302.68

These loans are classified as follows:

Type	Number of Loans	Unpaid Balance
Residence	4	$80,802.68
Commercial	1	139,500.00
Totals	5	$220,302.68

Mortgage Loans on Real Estate

The principal balances outstanding as of December 31, 1968, was compiled from the Company's subsidiary investment records.

Transactions in mortgage loans on real estate during the period under review were as follows:

Book value of mortgages owned December 31st, of previous year		$0
Cost of Mortgages Purchased	$202, 500. 00	
Due to merger Alexander Hamilton Life Insurance Company	64, 133. 64	266, 633. 64
Less: Payments on principal		(43, 455. 96)
Book value of mortgages owned end of year		$223, 177. 68

Interest received in the amount of $13,178.47 was verified and found to be correct as reported by the Company in its 1968 Annual Statement.

Accrued interest in the amount of $194.08 was not reported by the Company in its 1968 Annual Statement. This amount has been included in the admitted assets of this report under the caption "Investment Income Due and Accrued."

Escrow funds in the amount of $1,727.19 held by the Company on two mortgages are used to make disbursements for taxes and insurance as the occasion arises, and is included in the Company's 1968 Annual Statement among the liabilities under the caption "Amounts Withheld or Retained by Company as Agent or Trustee."

The resultant earnings on the mortgage loan account are indicated in the following exhibit:

	1965	1966	1967	1968
Mean Book Value	0	[1] $45, 000. 00	$197, 938. 53	$221, 777. 31
Interest Earned	0	$2, 677. 50	$13, 373. 40	$13, 178. 47
Rate of Return	0	5. 948%	6. 756%	5. 943%

[1] The only loan made in 1966 was made September 30, 1966 in the amount of $180,000.00. Since interest was earned on this loan for only three months, the mean book value has been shown as $45,000.00 to show a more meaningful rate of return for the year.

Loans made during the period under review were authorized at the meetings of the Board of Directors.

All pertinent documents covering loans were examined in detail as to mortgage, notes, deeds of trust, title policies, appraisals and hazard insurance policies. It was also determined that the Veteran Administration Loan was supported by proper Guarantee Certificate.

Company records showed that all tax payments were current.

Policy Loans, $4,445.33

This asset consists of twenty-two loans and represents the unpaid principal balance as of December 31, 1968. The loans bear interest at the rate of six percent per annum which is added to the loan or paid by the policyholder, at his option, on the next succeeding anniversary date of the policy. Interest is not computed or paid in advance. All loans were checked to the policy files and none were in excess of the cash values of the policies.

Interest due and accrued at December 31, 1968, in the amount of $76.03, has been shown as a non-ledger asset in the financial statement of this report.

Cash and Bank Deposits, $641,184.67

As of December 31, 1968, the Company maintained deposits in eleven banks and trust companies not on interest, aggregating the above amount.

Certifications of bank balances were obtained directly from the respective depositories and balances shown thereon reconciled with the Company's records. The depositories certified that the Company's accounts were free of liens, claims or encumbrances.

Interest received in the amount of $33,064.28 as reported by the Company at December 31, 1968, was found to be correct.

Amounts Recoverable from Reinsurers, $27,000.00

This non-ledger asset represents the amount due from a reinsurer on a loss paid by the Company prior to December 31, 1968. Vertification of this item was established from the settlement made by the reinsurer in January of 1969.

Premiums Receivable, $989,153.94

This non-ledger asset consists of premiums due from finance companies, banks and reinsurance assumed on individual and group credit life and credit accident and health business.

Premiums receivable at year end consisted of the following:

Life:		
Single premiums	$48,804.24	
Reinsurance assumed	42,466.37	$91,270.61
Group, direct	$272,077.91	
Group, pools	110,146.64	
Reinsurance assumed	5,834.25	388,058.80
Total life premiums		$479,329.41

Accident and Health:	*Individual*	*Group*	
Direct	$45,966.56	$384,821.12	
Pools		14,290.16	
Reinsurance assumed	29,328.62	35,418.07	
Totals	$75,295.18	$434,529.35	
Total accident and health			$509,824.53
Total premiums receivable			$989,153.94

The above amounts were verified by reports, settlements and deposits made subsequent to the year end. Commissions payable on the above premiums have been included in the liability section of this report under the caption "Commissions Due and Accrued".

The premiums receivable in the above schedule are shown by the Company separately from the deferred and uncollected premium schedule because in nearly all cases the premiums have been paid by the policyholder to the finance companies, banks, etc., but are not remitted to the Company until the following month.

Due Under Co-Insurance Agreements, $30,094.69

The above item represents premiums less commissions due for the months of October, November and December, 1968, under a co-insurance agreement. This was verified by the settlement statement and payment received by the Company in March of 1969.

Life Insurance Premiums Deferred and Uncollected, $630,119.58

		Ordinary		Group
	Total	1st Year	Renewal	Life
Gross Uncollected	$80,632.76	$6,420.22	$72,949.75	$1,262.79
Gross Deferred	844,588.78	264,834.67	579,754.11	----------
Total Gross	$925,221.54	$271,254.89	$652,703.86	$1,262.79
Less Loading	295,101.96	138,010.31	156,181.62	910.03
Net Deferred and Uncollected	$630,119.58	$133,244.58	$496,522.24	$352.76

All Ordinary business of the Company is administered in Denver, Colorado. This is now written directly by the Company, however, some insurance in force which was written in prior years in Puritan Life Insurance Company and The Credit Life Insurance Company was coinsured 50% in the Company.

Amounts of deferred and uncollected Ordinary business are determined by listing all policies in force grouped by originating company, premium mode, year and month of issue and year and month to which premiums are paid. The annual net life premium and the annual gross premiums for life, ADB, WP and substandard extra are listed. Amounts of deferred, uncollected and advance premiums are calculated by computer.

This list was test checked for method of determining these items, for accuracy of the net premium factors used and for accuracy of the insurance in force included.

A few policies were included on which premiums were overdue more than two or three months, however, these were also included in the reserve listings so the net liability is only slightly incorrect. On one plan, an incorrect net premium was used which resulted in a slight understatement of net deferred and uncollected premiums. This is being corrected for future listings. No change was made in this examination for these errors, since the net difference would be quite minor.

In addition to the regular life net premium, credit is taken for one-half of the gross premium on ADB and WP and for all of the gross substandard extra premium.

There is a small amount of group life premium due in connection with group business, other than group, administered in the St. Louis office.

Accident and Health Premiums Due and Unpaid, $702.20

This item is on individual A & H policies which are administered in Denver, Colorado. All policies with premiums due and unpaid are listed and the premiums on them are totaled. One or two monthly policies with premiums overdue more than one month were included for the full amount overdue, rather than only for one monthly premium on each. The overstatement of this asset was very minor so the Company's figure was accepted.

Investment Income Due and Accrued, $203,888.22

This non-ledger asset is comprised of the following:

Interest accrued on bonds	$203,618.11
Interest accrued on mortgage loans	194.08
Interest accrued on premium notes, policy loans and liens	76.03
Total	$203,888.22

The above captioned amount is $194.08 more than that reported by the Company in its 1968 Annual Statement. The increase of $194.08 was due to the Company not reporting interest accrued on mortgage loans.

Comments with respect to the foregoing items will be found under their related assets.

Funds Held By or Deposited With Ceding Reinsurers, $47,211.00

The captioned amount represents funds held by Old Republic Life Insurance Company, Chicago, Illinois to guarantee payment of incurred claims under a credit life and credit accident reinsurance agreement. Of the total amount of $47,211.00, $2,742.00 is apportioned to credit life and $42,773.00 to credit accident and health.

LIABILITIES

Aggregate Reserve for Life Policies and Contracts, $7,788,306.83

This item includes the reserve for regular Ordinary policies administered in Denver, Colorado and for individual credit life, group, credit life, other group and a group annuity administered in the St. Louis office. A breakdown of reserves in each office is as follows:

St. Louis Office	$6,139,757.83
Denver Office	1,648,549.00
Total	$7,788,306.83

A summary of reserves in the St. Louis office is shown below:

	Total	Ordinary	Group
Life Insurance:			
1941 CSO 3%, NL—			
Credit Life	$326,860.4	$33,611.85	$293,248.58
1960 CSG 3½%, NL—			
Credit Life	825,989.44	263,148.00	562,841.44

	Total	Ordinary	Group
Life Insurance—Continued			
1958 CSO 3% NL—Regular Group	$4,954.00	0	$4,954.00
Total Life Insurance	$1,157,803.87	$296,759.85	$861,044.02
Annuities: 1951 GA 3¼%, NL	$4,971,351.66	0	$4,971,351.66
Total Annuities	$4,971,351.66	0	$4,971,351.66
Miscellaneous: North Carolina Special Reserve	$10,602.30	$10,602.30	0
Total Miscellaneous	$10,602.30	$10,602.30	0
Grand Total—St. Louis Office	$6,139,757.83	$307,362.15	$5,832,395.68

The Company issues single premium level and single premium decreasing credit life insurance. In addition to direct issues, some credit life insurance is written by Pilot Life Insurance Company, Old Republic Life Insurance Company, and National Fidelity Life Insurance Company and ceded on a single premium basis to the Company. This insurance is written on an individual policy basis in some states and on a group basis in other states, however, all is of the single premium (rather than the outstanding balance) type.

Business written in Colorado, Florida, Ohio and Texas is valued on the 1941 CSO 3% basis; that written in other states is valued on the 1960 CSG 3½% basis.

The Company actually provides insurance for the greater of (1) the amount of insurance provided by the policy or certificate or (2) the amount of the loan balance. The latter is larger when loan payments are in arrears. The reserve is calculated on such higher amount.

Credit insurance policies or certificates are grouped by state, city or loan office, 10 year age group and 3 month durational group. They are listed individually, which leaves a good audit trail. Reserve factors are used which take account of the unexpired amount of insurance and the one year term reserve based on a mortality table and interest rate for an age which is believed to be representative of the age group as follows:

Ages	Under	20		Factor	Based	on	Age 18
"	"	20–29		"	"	"	" 26
"	"	30–39		"	"	"	" 36
"	"	40–49		"	"	"	" 45
"	"	50–59		"	"	"	" 55
"	"	60–65		"	"	"	" 63

The mortality factors and formulas for reserve calculation were checked. Those used for decreasing term were found to be correct, however, those for level term overstate the reserve by one-half month's insurance. The overstatement probably amounts to several thousand dollars, however, it could not be readily calculated exactly. This correction has not been made in the totals above. The overstatement of reserve has been brought to the attention of the Company and will be corrected in future valuations.

There is a small reserve on regular group life insurance.

The annuity reserve is on retired lives under a pension plan of the parent or an affiliated company. Reserves are calculated using a rather exact formula which recognizes a partial final payment at death.

North Carolina, by regulation requires with respect to credit life and credit A & H that "at least 40% of the gross premiums written by each agent must be accumulated by the insurance company indefinitely as an irrevocable reserve". This has been interpreted to mean that the total reserve on North Carolina direct business must be 40% of written premiums less 100% of claims, both on a to-date basis. The regular life and A & H reserves are included in their respective categories. The amount shown for this item represents the excess of the North Carolina requirement over the regular reserve. In calculating this reserve, the Company failed to deduct the A & H reserve held elsewhere, which amounted to $47,904.06. In correcting this, $31,438.96 of this reserve classified as A & H has been eliminated and the life portion has been reduced by $16,465.10, i.e. from the Company's figure of $27,067.40 to the $10,602.30 shown above.

A summary of the reserves on business in the Denver office, all of which is on Ordinary business, is shown below.

Life Insurance:

1958 CSO 3%, CRVM, Age Last Birthday	$1,511,660.00
" " " NL " " "	13,615.00

Life Insurance—Continued

Substandard Extra	$29,209.00
Total Gross	$1,554,484.00
Reinsurance	9,622.00
Total Net	$1,544,862.00
Accidental Death Benefits:	
Total Gross	$73,023.00
Reinsurance	4,809.00
Total Net	$68,214.00
Disability—Active Lives:	
Total Gross	$23,632.00
Reinsurance	188.00
Total Net	$23,444.00
Disability—Disabled Lives: Total Net and Gross	$3,791.00
Miscellaneous: Non Deduction—Total Net and Gross	$8,238.00
Grand Total	$1,648,549.00

The Ordinary business is grouped in order of originating company, plan, year of issue and age at issue. Each policy is listed and the appropriate life reserve is calculated. An estimate of the reserve was included for a few policies for which there were no matching reserve factors. The Company uses a three year age setback for reserves on female lives on most plans. The age last birthday method is used. Curtate functions are used.

The reserve for substandard extra premiums is calculated as one-half of the gross extra premium on policies in force.

The reserve for reinsurance ceded is calculated as one-half of the annual reinsurance premium on policies in force.

The reserve for accidental death benefits and disability active lives is calculated as one-half of the gross annual premium in force, which is an estimate of the tabular reserve. Since this business is less than five years old, with an average duration of about two years, this is probably a conservative estimate. However the amounts of reserve are large enough that a more exact and direct estimating technique should be used. This has been recommended to the Company.

The Company does not deduct deferred fractional premiums at death, however, it does not refund previously due premiums paid beyond the date of death. The non-deduction reserve is calculated by a method which relates the reserve to the amount of deferred premiums. The method is somewhat conservative on limited pay life plans, but gives a very accurate reserve on other plans.

Premiums were inspected and it was determined that no deficiency reserve is required.

In recapitulating, the reserve shown by the Company was adjusted to the amount shown above as follows:

Reserve Shown by Company	$7,804,771.93
Correction of North Carolina Special Reserve	(16,465.10)
Corrected Reserve	$7,788,306.83

Aggregate Reserve for Accident and Health Policies, $3,103,742.69

This item includes the reserve on credit A & H and regular group A & H insurance administered in the St. Louis office and on a small amount of individual guaranteed renewable disability policies administered in the Denver office.

The amounts of reserve held on each of these categories of business is as follows:

Denver office	$7,991.65
St. Louis office	3,095,751.04
Total	$3,103,742.69

The reserve on the individual disability policies is as follows:

Active Life Reserve:	
Unearned Premiums—Total Gross	$3,455.82
Reinsurance Ceded	2,457.65
Total Net—Active Life Reserve	$998.17
Claim Reserve:	
Present Value of Amounts Not Yet Due—Total Gross	$9,517.88
Reinsurance Ceded	$2,524.40
Total Net—Claim Reserve	$6,993.48
Grand Total	$7,991.65

The unearned premium reserve is calculated using the exact fraction as if each premium due date were in the middle of the month.

No additional reserve calculated on a morbidity table and interest rate is held since almost all business was of less than two years duration. An additional reserve will be calculated in future years when some business will be in its third year.

The claim reserve is estimated by assuming that claims will be 50% of earned premiums and subtracting paid and pending claims to arrive at the amount of liability for unaccrued claims. It appears to be a rather conservative estimate.

The reserve on individual credit, group credit and regular group A & H policies, i.e. those administered by the St. Louis office is as follows:

	Total	Group	Other
Active Life Reserve: Unearned Premium—Total Gross & Net	$2, 432, 501. 04	$2, 153, 903. 14	$278, 597. 90
Claim Reserve:			
Present Value of Amounts Not Yet Due	$631, 000. 00	$561, 000. 00	$70, 000. 00
Reserve for Future Contingent Benefits	32, 250. 00	32, 250. 00	0
Total Gross and Net	$663, 250. 00	$593, 250. 00	$70, 000. 00
Grand Total	$3, 095, 751. 04	$2, 747, 513. 14	$348, 597. 90

The unearned premium reserve is on credit A & H insurance. Both the group and individual business is sold on a single premium basis. The unearned premium reserve on business in Louisiana and part of that on Maryland and Rhode Island business is calculated on the pro-rata method. The balance of the unearned premium reserve is calculated on the rule of 78's, i.e. the sum-of-the digits, method. The factors were checked and found to be correct on the latter, but found to overstate the reserve by one-half month on the pro-rata method. The total overstatement is relatively minor because most of the busi-

ness is not valued on the pro-rata method. This was not corrected in the figures above, however, it was brought to the attention of the Company and factors will be considered in the future.

The reserve for "Present Value of Amounts Not Yet Due" is $490,340.00 greater than that reported by the Company, and is fully commented upon under the caption "Policy and Contra t Claims—Accident and Health."

The reserve for future contingent benefits, i.e. deferred maternity, is estimated from such type of claim payments in 1968 and from the growth in volume. The estimate appears to be reasonable.

The Company had included $31,438.96 of special reserve for North Carolina direct credit A & H policies. As discussed under the heading "Aggregate Reserve for Life Policies and Contracts", this reserve was overstated and has been eliminated from the A & H reserve above and reduced in amount in the life reserve item.

Policy and Contract Claims—Life, $428,772.57

The above liability consists of the following:

	Ordinary	Group	Total
In course of settlement	$134,040.87	$101,587.56	$235,628.43
Incurred but not reported	88,140.36	105,003.78	193,144.14
Totals	$222,181.23	$206,591.34	$428,772.57

The liability for ordinary life claims was verified from a review of the claims register and payments made in 1969 for claims incurred prior to January 1, 1969, with an additional amount reserved for claims reported subsequent to the experience period.

The amount for group claims was determined from a listing of payments made during the first four months of 1969 on claims incurred in 1968 and from reports received from ceding insurers.

Minor differences were noted during the review of the above. However, the differences were compensating and a change in

the liability as reported by the Company in its annual statement was deemed unnecessary.

A review of claims files determined that the Company settles claims promptly and in accordance with the policy contracts.

Policy and Contract Claims—Accident and Health, $352,657.65

This liability is $306,572.35 less than that reported by the Company. Whereas the above captioned amount includes only that portion of the claims liability applicable to "accrued" claims at December 31, 1968, comments on the associated reserve for "unaccrued claims" are combined hereunder in lieu of separate remarks under the sub-heading "Present Value of Amounts Not Yet Due on Claims" in the "Aggregate Reserve for Accident and Health Policies" section of this report. Both liabilities are shown in the following schedule by classification:

	Per Company	Examination Change	Per Examination
Liability for Accrued Claims:			
Credit (Individual and Group)	$503,731.00	($376,900.68)	$126,830.32
Group	142,000.00	70,550.00	212,550.00
Individual	1,275.00	(221.67)	1,053.33
FEGLI	12,224.00	0	12,224.00
Total Accrued	$659,230.00	($306,572.35)	$352,657.65
Reserve for Unaccrued Claims:			
Credit (Individual and Group)	$140,660.00	$490,340.00	$631,000.00
Group	0	0	0
Individual	6,993.48	0	6,993.48
FEGLI	0	0	0
Total Unaccrued	$147,653.48	$490,340.00	$637,993.48
Total Claim Liability	$806,883.48	$183,767.65	$990,651.13

The total claim liability as shown above is distributed between unaccrued and accrued as follows:

	Per Company	Examination Change	Per Examination
Unaccrued: Present value of amounts not yet due	$147, 653. 48	$490, 340. 00	$637, 993. 48
Accured:			
In course of settlement	$56, 867. 15	$38, 638. 34	$95, 505. 49
Incurred but not reported	602, 362. 85	(345. 210. 69)	257, 152. 16
Total accrued	$659, 230. 00	($306, 572. 35)	$352, 657. 65
Total Claim Liability	$806, 883. 48	$183, 767. 65	$990, 651. 13

A total claim liability for accrued and unaccrued claims on credit A & H is estimated by an analysis of claims by month of accrual and month of payment. The reserve is being phased into the figures determined from this study. In addition, an estimate of the total claim liability is made for regular group and an amount is included for FEGLI. In years prior to 1968, the comparison in Schedule H (and in earlier years Schedule O) indicated the total A & H claim liability was inadequate.

In establishing the total examination reserve for credit and group claims, a four month development period was used and the ratio of paid claims was compared with the Company's past experience, both on a cumulative as well as on an incurred month basis. Appropriate lag factors were established to estimate the amount still unpaid based upon the lag indicated as compared with previous experience.

Premiums Received in Advance, $9,193.71

This liability is held with respect to the Ordinary policies administered in Denver, Colorado. The entire amount is on life insurance; any advance premiums on A & H insurance is included by the Company in the unearned premium reserve.

Advance premiums are determined in conjunction with deferred and uncollected premiums. All policies are grouped by company (i.e. direct business or that reinsured from Puritan Life Insurance Company or The Credit Life Insurance Com-

pany), month and year of issue and month and year to which premiums are paid. Each policy is listed individually. The computer calculates the amount of advance premiums. In this calculation, any premium paid in advance of its due date but not beyond the policy anniversary is offset against the amount of deferred premium.

Premium Deposit Funds, $7,911.05

The above ledger liability consists of amounts paid in advance which will be used to pay the premiums on the anniversary or due dates of the policies.

The Company maintains a listing of the policies involved showing the anniversary date, payment amounts and dates and the balance in the fund. The policyholders may make payments on a monthly, quarterly, semi-annual or annual basis. A review of the records disclosed no errors of consequence.

Commissions Due or Accrued, $333,733.41

This liability consists of commissions payable on the premiums receivable shown in the asset section of this report, to agents writing ordinary business and on a contract in which the commissions are settled or paid on an annual basis. It is divided between life and accident and health business as follows:

Life	$150,592.14
Accident and health	183,141.27
Total	$333,733.41

The above was determined by using actual payments and reports of commissions incurred.

General Expenses Due or Accrued, $83,166.40

This liability was established by a review of paid invoices and disbursement records pertaining to expenses paid subsequent to December 31, 1968, but having their origin on or prior thereto.

The captioned amount is $25,581.58 in excess of the liability reported by the Company in it's 1968 annual statement.

Taxes, Licenses and Fees Due or Accrued, $225,454.73

The captioned amount represents the Company's liability for taxes, licenses and fees due or accrued at December 31, 1969. The major portion of this amount consisted of state premium taxes, which were paid during the course of this examination. The remainder of the above amount was made up

of the usual items, such as state licenses and fees, F.I.C.A. taxes and miscellaneous taxes.

The captioned amount was determined by an examination of the Company's tax returns and related items for the year 1968, and resulted in a decrease of $29,430.20 less than that reported by the Company in it's 1968 annual statement. This difference was determined to be an advance partial payment of premium taxes to California and Ohio, for which the Company did not take credit in it's Annual Statement.

Federal Income Taxes Due and Accrued, $1,189,806.63

On August 18, 1967, the Company filed claims for refund of taxes paid for the years 1963, 1964 and 1965 totaling $343,884.04. No action having been taken by the Revenue Service to allow or disallow the claims, the Company on April 4, 1968, filed suit for refund in the United States Court of Claims. This suit is still pending.

On October 24, 1968, the Commissioner of Internal Revenue mailed the Company a statutory notice of deficiencies for the years 1963, 1964 and 1965, totaling $965,774.95 plus interest. Subsequently, notices of assessment and demand for payment dated February 25, 1969, were received by the Company. The Company paid the deficiencies and interest on March 5, 1969.

On April 21, 1969, the Company filed claims for refund of taxes and interest paid totaling $1,197,684.97. These claims and the suits in the United States Court of Claims are still pending as of the examination date of this report. The deficiencies in tax were based on industry-wide issues being contested in the courts by other companies.

The amount shown above includes the deficiencies paid plus the interest to December 31, 1968. The income tax return for the calendar year 1968 has not been filed as of this date, the Company having been granted an extension of time to file its return, and it appears that no tax is due.

Cost of Collection on Deferred and Uncollected, $107,860.06

Premiums in Excess of Total Loading

In 1968, the Company determined this liability for the first time. Prior to 1968, first year commission rates were relatively low. In 1968, two increases in the first year commission rate were granted, so that the rate with all overrides on life plans is 90%. Renewal commission rates were reduced, however, exist-

ing renewal business continues to be subject to the higher renewal rates.

This liability was determined as the excess of a 90% first year commission rate over the amount of first year loading in deferred and uncollected premiums. It is a rather conservative method of determining this item in that (1) not all plans take the 90% commission rate, (2) the first year business issued earlier in 1968 was subject to lower commission rates and (3) the loading margin in renewal years is not used as an offset to the loading deficiency in the first year.

Amounts Withheld or Retained by Company as Agent or Trustee, $15,747.88

The above captioned liability is composed of the following accounts:

Decor Interiors	$5,796.78
Employees' insurance withheld	421.67
Employees' savings bonds withheld	336.27
Missouri State Tax withheld	980.14
Federal income tax withheld	4,357.09
Federal income tax withheld—Puerto Rico	161.55
Federal Insurance Contributions Act Taxes withheld	809.50
Federal Insurance Contributions Act Taxes withheld—Puerto Rico	94.21
Accrued Colorado State withholding tax	1,016.22
Accrued California Unemployment Compensation and Disability Tax withheld	47.26
Mortgage escrow funds	1,727.19
Total	$15,747.88

Decor Interiors

This liability covers interior decorations made in the office in which the Company was not satisified and payment was held up until this was corrected. This was paid by the Company on January 24, 1969.

Employees' insurance withheld

This item is for additional insurance taken by the employees to supplement that for which the Company pays and also to cover the employees' dependents. This balance was verified by a review of the Company's records and found to agree with the amount reported in the Company's 1968 Annual Statement.

Employees' savings bonds withheld

The Company maintains savings bonds record cards to support this liability. Control cards were checked and found to agree with the amount as reported by the Company as of December 31, 1968.

The federal and state withholding taxes were verified by a review of tax reports and disbursements in January 1969, to ascertain dates of payment.

Mortgage escrow funds were verified and commented upon in connection with the examination of mortgage loans.

The subsidiary records of the above eleven liability accounts agreed with the Company's general ledger as of December 31, 1968.

Remittances and Items not Allocated, $26,045.80

Ledger suspense accounts and miscellaneous items are summarized as follows:

Cash with applications	$24,842.05
Old outstanding checks	1,043.26
Miscellaneous suspense	2,717.39
Due Hamilton Management Corporation	(2,556.90)
Total	$26,045.80

Old outstanding checks represent approximately 225 checks and were written in the years 1964 through 1967.

The debit balance in the "Due Hamilton Management Corporation" account represents the residual balance after accruals were reversed for annual statement reporting.

Mandatory Securities Valuation Reserve, $38,048.65

This item represents the accumulated reserve as of December 31, 1968, computed within the required limits, on the basis prescribed by the Valuations Committee of the National Association of Insurance Commissioners.

The accumulated reserve as of December 31, 1968, developed by this examination is $1,684.61 less than that reported by the Company in its 1968 Annual Statement.

The decrease was due to the Company's error in computing this reserve.

Deferred Pension Benefits, $3,500.00

The personnel of ITT Hamilton Life Insurance Company participate in the pension plan of the parent, International Telephone and Telegraph Corporation, with respect to service after August 31, 1964. In addition in 1968, four employees were granted a similar pension credit with respect to service with American Universal Life Insurance Company, the predecessor of ITT Hamilton Life Insurance Company, between September 1, 1959, and August 31, 1964. This was by Board resolution but it is not funded through the regular pension plan. The lump sum value of these benefits as of January 1, 1968, was calculated by ITT Hamilton Life Insurance Company's consulting actuaries as $25,846.00, however, the basis of this calculation was not the same as that used by the parent company in its pension calculations. ITT Hamilton Life Insurance Company proposes to set aside $3,500.00 each year for 15 years to provide for these benefits. This amount is not supported directly by a calculation, however it appears to be reasonable in the light of the calculated lump sum cost.

Due to Subsidiary, $211,287.14

This non-ledger liability represents tax benefits due the Company's subsidiary, ITT Life Insurance Company of New York. The Company issued its check and voucher on March 31, 1969, in payment of this liability.

Mortality Fluctuation Reserve, 0

The Company absorbs the mortality risk of ITT Life Insurance Company of New York through a reinsurance treaty under which it receives a premium equal to the expected cost of insurance plus a small expense charge. This became effective October 1, 1968. Experience in the first three months of this treaty was adverse to ITT Hamilton Life Insurance Company. Management set up a mortality fluctuation reserve in an amount roughly related to a year's projection of this adverse experience.

Although the Company classified this $537,200.00 as a liability, it has been reclassified by the examiners as a part of earmarked surplus. This is not for reserve strengthening nor for contingent losses having a measurable probability of occurrence. Thus it should be classified as earmarked surplus. The

setting up of any amount in this caption is entirely voluntary and within the discretion of management.

Capital Paid-Up, $1,000,000.00

Inspection of the Company's stock certificate books showed that there were two open stubs showing the issuance of 1,000,000 shares of stock having a par value of $1.00 each and is owned in its entirety by the ITT Aetna Finance Company.

All of the cancelled certificates including those of the former Alexander Hamilton Life Insurance Company, Denver, were accounted for during the course of this examination.

Surplus as Regards Policyholders, $4,679,128.38

After evaluating the assets and providing for all known liabilities and reserves the surplus of the Company as determined by this examination totaled $4,679,128.38. This amount is $738,407.09 less than shown in the Company's 1968 Annual Statement.

The items effected by the surplus changes are shown in the following reconciliation:

Total Surplus per Company, December 31, 1968 (Paid in $2,580,348.74; Unassigned $2,837,186.73)			$5,417,535.47
	Surplus Changes		
	Increase	Decrease	
Assets:			
Mortgage Loans		$2,875.00	
Investment Income Due and Accrued	$194.08		
Funds Held by or Deposited With Ceding Reinsurers	47,211.00		
Liabilities:			
Aggregate Reserve for Life Policy Contracts	16,465.10		
Aggregate Reserve for Accident and Health Policies		458,901.04	
Accident and Health Policy and Contract Claims	306,572.35		
General Expenses Due or Accrued		25,581.58	
Taxes Licenses and Fees Due or Accrued	29,430.02		
Federal Income Tax Due or Accrued		1,189,806.63	
Mandatory Security Valuation Reserve	1,684.61		
Mortality Fluctuation Reserve	537,200.00		
Total	$938,757.16	$1,677,164.25	
		(938,757.16)	
Net Decrease in Surplus			738,407.09
Total Surplus per Examination December 31, 1968			$4,679,128.38

(Special Surplus Funds $537,200.00; Paid in $2,580,348.74; Unassigned $1,561,579.64)

GENERAL COMMENTS

The following comments are offered in accordance with the recommendations contained on Pages A16 and A17 in the Examiners Handbook published by the National Association of Insurance Commissioners under the subject of "Procedure Regarding Examination Report."

Denver Office—This office produces all of the Company's Ordinary business and is closely associated with the Hamilton Funds, Incorporated, with offices also in Denver, Colorado. Many representatives of the latter also write insurance for the Company. The Denver office maintains accounting records, including a general ledger; collects premiums, pays its own operating expenses including claims. During the course of the examination two (2) examiners were dispatched to Denver, Colorado, to audit the affairs of this office.

A servicing agreement currently in effect with the Hamilton Management Corporation, generally provides that the servicing company will furnish the Denver office all necessary postage, office furniture and equipment, telephone charges and such other administrative, sales, sales promotional services and all other services for which no separate billing or agreement heretofore has been made.

In consideration for furnishing the foregoing the Company agrees to pay Hamilton Management Corporation a percentage of all First Year Premiums Collected by the Denver office, as follows:

Range		Percentage
First	$100, 000	15
Next	200, 000	10
Next	200, 000	5
Next	500, 000	3
Over	1, 000, 000	2

During the period under examination service fees have been paid, as follows:

1965	$42, 666. 28
1966	48, 233. 13
1967	47, 246. 25
1968	44, 628. 65

The aforedescribed service agreement may be terminated at any time upon sixty (60) days written notice by either party.

There is also in effect with the Hamilton Management Corporation a "Space Rental Agreement," whereby the Denver office subleases space at 777 Grant Street, Denver, Colorado, at $1,000.00 annually per each full time employee, payments to be calculated monthly. The rental agreement stipulates that space shall be limited to the amount that Hamilton Mangement Corporation, at its discretion, shall make available for use by the Company. Sums shown as rental disbursements in the Denver office general ledger during the period under review, were as follows:

1965	$16,915.00
1966	28,666.14
1967	34,581.95
1968	28,248.87

The Space Rental Agreement is in effect until May 31, 1974, and it along with the Service Agreement were negotiated by the Alexander Hamilton Life Insurance Company, before the Company acquired the business of the latter. However, all parties involved in the agreements are owned controlled by the International Telephone and Telegraph Corporation of New York.

Accounting Records—Two general ledgers are maintained by the Company, one for transactions of the Denver office and the other for Home Office business. At each year-end the accounts in these ledgers are combined and form the basis from which annual statements are prepared.

Also, at each year-end, the Company books all non-ledger assets and liabilities as respects Home Office transactions but such accruals are reversed in January of the following year. Under the circumstances it was necessary to adjust trial balances from the accrual to the cash basis in order to reconcile annual statement items.

The Company informs that commencing January 1, 1969, its general ledger accounts at year-end closing will reflect the conditions of such accounts on a cash basis.

CONCLUSION

The actuarial and related phases of this examination were performed by and under the supervision of Thurston P.

Farmer, Jr., F.S.A., Consulting Actuary of the Missouri Division of Insurance.

Following are the examiners of the Missouri Division of Insurance who were associated in the examination and the preparation of this report: Peter J. Gera and Edward A. McKee.

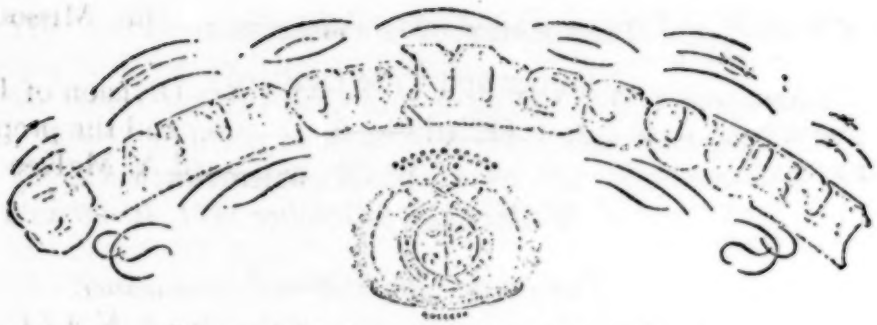
Respectfully submitted,

A. P. HOOD,
Examiner, Missouri Division of Insurance,
State of Missouri, Representing Zone 3, N.A.I.C.

EARL G. TERRY,
Examiner, Insurance Department,
State of Maryland, Representing Zone 2, N.A.I.C.

SVERRE MATHISON,
Examiner, Insurance Department,
State of Wyoming, Representing Zone 5, N.A.I.C.

HENRY CHIN,
Examiner, Department of Insurance,
State of California, Representing Zone 6, N.A.I.C.



DIVISION OF INSURANCE

DEPARTMENT OF BUSINESS AND ADMINISTRATION

CERTIFIED COPY

I, WILLIAM Y. McCASKILL, Superintendent of the Division of Insurance Department of Business and Administration of the State of Missouri, do hereby certify that the annexed pages are a true and correct copy of the original

Report of Examination of the

ITT HAMILTON LIFE INSURANCE COMPANY

as of December 31st, 1968

which said original is now on file in this Division.

IN TESTIMONY WHEREOF, I have hereunto set my hand and caused to be hereto affixed the seal of said Division, at my office in the City of Jefferson, this 8th day of August 19 69

WILLIAM Y McCASKILL
SUPERINTENDENT

By _____
DEPUTY SUPERINTENDENT

By Charles Salmon
CHIEF CLERK

BEST COPY AVAILABLE

TRANSCRIPT OF PROCEEDINGS

(Number and Title Omitted)

(Filed ——)

WASHINGTON, D.C.,
Wednesday, 6 October 1971, 10:00 a.m.

Testimony for Plaintiff

The parties met, pursuant to notice of the Commissioner, at the time above stated, in Trial Court Room 7, Court of Claims Building, Washington, D.C.

Present: Hon. Lloyd Fletcher, Commissioner; John B. Jones, Jr., Esq.; Andrew W. Singer, Esq.; and Owen Armstrong, Esq., counsel for Plaintiff; and Roger A. Schwarz, Esq., counsel for Defendant.

William L. Shimeta, a reporter, was thereupon sworn by the Commissioner to well and truly take down and transcribe the questions propounded to and the answers given by the witnesses, and to do all other things required of him by the Commissioner.

Pursuant to the order of reference by the Honorable, the United States Court of Claims, in the above-entitled cause, testmony on behalf of the Plaintiff was taken, as follows:

* * * * *

[18] MR. SINGER. Roger, have you decided whether to accept this witness as an expert?

MR. SCHWARZ. Yes, we will.

MR. SINGER. Can we then submit the first three paragraphs that I spoke to you about?

MR. SCHWARZ. Yes.

MR. SINGER. Mr. Fletcher, the parties have stipulated that Mr. Eddy has the following qualifications listed, [19] and we will give you a signed copy of that with our supplemental stipulation. Mr. Eddy.

THE COMMISSIONER. Good morning, Mr. Eddy. It is a pleasure to see you again.

ARTHUR CROOKS EDDY, a witness produced on behalf of the Plaintiff, having first been duly sworn by said Commissioner, was examined and testified as follows:

THE COMMISSIONER. Please be seated and state your full name and address for our reporter, please.

The WITNESS. My name is Arthur Crooks Eddy, 2935 Whispering Hills Drive, Atlanta, Georgia.

Mr. SCHWARZ. If I may, may I ask Mr. Eddy one question on voir dire in addition to what is listed in that paragraph?

The COMMISSIONER. Relating to the qualifications, Mr. Schwarz?

Mr. SCHWARZ. Yes.

The COMMISSIONER. Yes, you may.

By Mr. SCHWARZ:

Q. Mr. Eddy, in connection with your work as an actuary with Pilot and with other companies, and in your independent capacity as a consulting actuary, have you also prepared federal income tax returns for insurance companies?

[20] A. Frequently, yes.

Q. And you have considered the tax significance of many of the insurance concepts that are used in filling out the annual statement forms required and adapted those to proper use under federal income tax law?

A. I think that would be correct, yes.

The COMMISSIONER. Very well. I understand that Counsel are in agreement and will stipulate that the witness is qualified as an expert. Proceed, Mr. Singer.

Mr. SINGER: Thank you.

DIRECT EXAMINATION

By Mr. SINGER:

Q. Mr. Eddy, have you examined the accident and health reinsurance treaties between the American Universal Life Insurance Company, which, as you know, is the former name of ITT Hamilton, and the Old Republic, Pilot, and National Fidelity Life Insurance Companies?

A. Yes, sir, I have.

Q. For the record, those treaties are Exhibits #2, #4, and #6. Do these treaties, or any provisions of these treaties, appear unusual to you in any respect?

A. No, sir, not unusual. I think they are quite common in the credit insurance industry.

Q. Mr. Eddy, we have stipulated in this case that all [21] of the policies that were reinsured under these treaties were credit insurance policies on which a single premium was paid

to the insurance company at the inception of the policy coverage. Is there anything unusual in the fact that the reinsurance treaties here called for the payment of reinsurance premiums by the issuing company to ITT Hamilton on a monthly earned premium basis when the issuing company had received a single premium in advance, when it issued the policy?

A. No, I don't think so. In fact, I think that this is not an unusual arrangement in other types of reinsurance contracts. First of all, the contracts are between the two insurance companies and not between the ITT Hamilton and the policy holder, so it is a completely different arrangement. The policy holder may have individual life insurance. He may be paying his premiums on an annual basis, but the policy may be reinsured with another insurance company for the risk element, and the premium is to be remitted to the reinsurer, say, on a monthly basis. So I feel that that's not uncommon. In particular do you find this a common practice in the reinsurance of credit accident and health insurance.

Q. Thank you. Mr. Eddy, we have stipulated in this case that Old Republic, Pilot, and National Fidelity reflected unearned premium reserves on policies insured with ITT Hamilton in their annual statements. Perhaps before we [22] get to this, Mr. Eddy, perhaps you could clarify for the Court what is an annual statement—what is the purpose of an annual statement.

A. Well, the annual statement of a life insurance company, or life insurance company issuing life insurance and accident and health insurance, is a record of the income and disbursements of the company during the year on an accrual basis, as well as a balance sheet, representing their solvency, reflecting their solvency at the end of the accounting period, which is normally the calendar year. As a matter of fact, it is prescribed as the calendar year with respect to the life insurance companies.

Q. Must all life insurance companies file the same annual statement form?

A. Well, yes. The National Association of Insurance Commissioners have an organization, or is an organization which has over the, say, the last seventy years, at any rate, has been generally trying to create uniform regulation amongst the states, which includes the reporting or the accounting for the

life insurance industry, and all states to my knowledge have adopted this uniform convention blank which they have prescribed, including the instructions for the completion of this statement—well, as a matter of fact, for reporting to the supervisory or regulatory authorities. All insurance [23] companies in the United States use the same form.

Q. Now, getting back to my previous question, we have stipulated in this case that Old Republic and Pilot and National Fidelity all reflect on their annual statements their unearned premium reserves on the policies they issued and that they reinsured with ITT Hamilton, and conversely we also stipulated that ITT Hamilton did not reflect such unearned premium reserves on its annual statements.

Now, before we get into this matter any further, could you explain to us what the understanding is, as to what an unearned premium reserve is in the statutory sense or in the sense that it would be reflected on the annual statement.

A. Well, yes, an unearned premium reserve, as commonly thought of in the insurance business, is that portion of a premium which has been received which has not been earned at the valuation date.

By earned, I mean if the premium paid or received by the insurance company was to cover a period of time, say, as an example, one year, and the premium was received on July 1 and the valuation date would be December 31, then the unearned portion would be one-half of such premium, and that being, or representing, of course, the period of time of the coverage which had not yet been exposed to risk.

Q. Is it possible that an unearned premium reserve [24] might be required when a company, as of the statement date, had not received premiums, any portion of which you—or no portion of which was represented insurance to be provided in the future?

A. Not in my opinion, no, sir.

Mr. SCHWARZ. I didn't understand that question.

Mr. SINGER. Let me put it this way.

By Mr. SINGER:

Q. If a company received premiums which represented a payment for insurance, already provided by the company, and had received no other premiums by the time, at its statement

date, would it be required in your view to set up an unearned premium reserve?

A. You mean the period of coverage had expired with respect to the premium being paid?

Q. Yes, sir.

A. The valuation date?

Q. Yes.

A. There would be no unearned premium.

Mr. SINGER. Is that satisfactory?

Mr. SCHWARZ. Yes, thank you.

By Mr. SINGER:

Q. Mr. Eddy, could you tell us what function the unearned premium reserve serves—functions, if there are [25] more than one?

A. With respect to accident and health insurance?

Q. Yes.

A. Yes, the unearned premium, first of all, represents in part funds that must be held to provide the cost of the insurance risk which has not yet expired. The accident and health unearned reserves, which the industry requires, is statutory reserve—it is on a gross basis and, therefore, includes an additional amount over and above this cost of insurance risk which is frequently referred to as loading and represents a number of things.

It is rationalized in the industry, in accident and health insurance, as required in the event that the policy holder should cancel their coverages at that moment of time because the refund provisions in most such contracts and in credit contracts particularly, provide that they would be refunded their gross amount rather than the net amount for the unearned portion of their coverage, and, of course, this is an evolutionary thing, as far as the regulations, in my opinion, because the accident and health business in the early days in this country was strictly on a cancelable basis. It was short term coverages, and the policy holder and the company both had the opportunity or the right contractually to cancel the coverage at some midpoint of a period in which [26] event the policy holder generally was given a pro rata refund. And, of course, as most of this insurance in the early days was issued by casualty companies and in some cases specialty companies issuing just accident and sickness insurance, this requirement to reserve on a gross basis in

effect earmarked in a sense a portion of these companies' surpluses, which gave them an additional test of solvency as of a valuation date. Actually, if the coverage had expired, this redundancy would have been turned into income and gone into surplus. Have I answered your question?

Q. Well, as I understand your answer, you have given at least two reasons why a company is required under certain circumstances to set up an unearned premium reserve. One would be to measure the cost of carrying the insurance risk and the second would be to refund premiums to policy holders in the event of cancellation. Is that a fair summary of your testimony?

A. Right. I might add that since the probability of cancellation is less than one, that to hold all of the loading would be unnecessary for purposes of refunding. There might be an additional reason to hold a portion of the gross, and that would be for expenses not yet incurred, and companies might then have a reason—three reasons at least for gross unearned premiums as opposed to, say, net unearned premiums.

[27] Q. You mean to the extent that the expenses had not already been incurred, this loading portion might be viewed as a reserve for future expenses?

A. To that extent, yes, sir.

Q. But have I understood you to say that the gross unearned premium reserve is not a true measure of the cost of carrying the insurance risk or exceeds the cost of carrying the insurance risk?

A. That's correct. The insurance risk would be the morbidity element in accident and sickness insurance or the life insurance—I mean the death element—the mortality element in the life insurance policies.

Q. Then in your opinion, is the difference between the gross unearned premium reserve and this net premium element or morbidity reserve, is that a true insurance reserve?

A. Well, not in respect to the risk.

Q. From an actuarial standpoint?

A. Not in that respect.

Q. It is not necessary to cover the cost of carrying the insurance risk?

A. No, sir.

Q. Mr. Eddy, having read the treaties that I mentioned earlier, the accident and health treaties between ITT Hamil-

ton and Old Republic, Pi ot, and National Fidelity, do you have [28] an opinion as t whether, from an actuarial standpoint, from the standpoint of state regulatory practices, whether ITT Hamilton was proper in not reflecting unearned premium reserves under these treaties on its annual statements?

A. Yes, that is my opinion. I believe that to be——

Q. I asked you whether you had an opinion.

A. Yes, sir.

Q. What is that opinion?

A. My opinion is that they were proper in not including these reserves in their statement.

Q. Mr. Eddy, can you tell us what a runoff provision is?

A. Yes, that's a term that really—it's intended to reflect a provision, say on a reinsurance agreement, whereby the reinsurer is barred from canceling reinsurance with respect to policies in force at any moment of time, in protection of the ceding company or to protect the ceding company, and it causes the reinsurer, if he should want to cancel the contract, to guarantee to the ceding company that he will continue to accept premiums on such policies that were then in force and until they reached their normal expiration date and, of course, pay claims as a result of any losses.

Q. Do either the Old Republic or Pilot or National Fidelity accident and health reinsurance treaties that we [29] are speaking about here, contain a runoff provision?

A. Yes, two of them do. The Pilot and the National Fidelity treaties provide for that.

Q. The Pilot and National Fidelity treaties do provide a runoff provision?

A. Yes.

Q. Does the Old Republic treaty?

A. No.

Q. In other words, under the Old Republic treaty, could ITT Hamilton cancel insurance, even insurance in force, if it wanted to?

A. Yes, sir, that's my interpretation.

Q. I previously asked for your opinion as to whether it was proper for ITT Hamilton to—not to reflect unearned premium reserves under any of these treaties. Did you take into account, in reaching your conclusion, the fact that the Pilot and Na-

tional Fidelity treaties had this runoff provision which, as I understand, obligates ITT Hamilton to continue reinsuring policies that were issued before they canceled the treaty?

A. My definition of the unearned premium, on a retrospective basis, that's the amount of money, proportionate amount of money that must be retained at the valuation date for a period of coverage which had been provided for by the [30] premium itself, which had not expired at that date.

All of these treaties, even though they differ in the runoff provision, the premium payments received by ITT Hamilton were after the expiration of the period of coverage for which the premium was paid, and, therefore, by that definition retrospectively there could be no unearned premium reserve with respect to Hamilton, even though these premiums differed in that one respect.

There would have been a difference in the reserves or liabilities held by ITT Hamilton between these two—these two different type treaties, and that has to do with the reserve for losses, unpaid losses and unreported or—incurred but unreported claims.

In the case of the Pilot and National Fidelity, the ITT Hamilton would have held at any valuation date some reserve for claims that had already been incurred prior to the valuation date for which it had incurred claims but maybe notice had not been received, or in the case of claims where notices had been received but payments hadn't actually been disbursed, there would be a liability for those, and that's not true, though, with the Old Republic treaty, in which the Old Republic itself, the way it remitted premium payments to ITT Hamilton, they deducted in effect an incurred loss from the cash premiums transferred, so in effect Old Republic held [31] the entire liability with respect to losses, unpaid losses.

So they differed in that respect, and it is my understanding that the terms of these treaties were followed in their accounting and it seems that they did in fact account for loss reserves, as I have just described, in a different manner between the two treaties.

Q. Could you just very briefly tell us the difference between unearned premium reserve and an unpaid loss reserve?

A. Well, yes. The distinction has to do with the point of time. The loss reserves are for losses already incurred at the point of

valuation. The unearned premium reserves are for losses to be incurred beyond the point of valuation. One is a prospective point of view and one of them is retrospective.

Q. Well, Mr. Eddy, do I understand you correctly then that the mere obligation to provide insurance in the future, even if it is a binding obligation, to continue to insure for a certain period of time, does not of itself give rise to the necessity for an unearned premium reserve? Is that correct?

A. No, as a matter of fact, if this prevailed in individual policy life insurance, you would have the usual contract. The usual permanent policy provides for coverage throughout the man's life, and he may have just paid up one month's premium. So it would be unsound—it would be [32] impossible to have an insurance operation if the company were required to reserve for all future premiums had they not received the premiums. The unearned premium reserve in my opinion has not to do with the risk at a moment of time but has to do with the unexpired risk, proportionate to the premium paid or received, and that in fact is the way the insurance companies measure their unearned premium reserves, is to determine for every policy for which it has received a premium what is the unexpired period of coverage, and then they take a proportionate part in accident and sickness insurance—they take a proportionate part of the gross premium. In other lines of insurance they take a proportionate part of the net premium.

Q. Well, is it correct to say that you can't have, or no company would be required to set up an unearned premium reserve unless they had been paid for insurance which had not yet been provided as of the statement date, unless they had been paid for insurance to be provided in the future?

A. That's my opinion, yes, sir. I can't conceive of anything to the contrary.

Q. Mr. Eddy, is it conceivable that although a company would not have to set up an unearned premium reserve merely by reason of having an obligation to provide insurance in the future, that it might have to set up some other kind of [33] insurance reserve to reflect the fact that it was obligated, although it hadn't been paid for the insurance—it was obligated to perform it, rather to give it in some way in the future?

A. Well, there are types of insurance where you do have a reserve that is different from the—what's commonly referred to as the unearned premium reserve.

For instance, in individual ordinary life insurance contracts, your reserve requirements are defined both retrospectively and prospectively, and the reserves are equal whether calculated by either of these approaches.

Retrospectively it's very much like I have already discussed the unearned premium or the unearned gross premium on accident and sickness. It's a reserve or an accumulation of premiums paid for a period of coverage not yet expired.

Well, this is true in life insurance in effect, even though the reserves are referred to as tabular reserves or life insurance reserves as opposed to unearned premium. They are in effect a type of unearned premium. They happen to be on a net basis for life insurance, but on a level premium life insurance there is in effect an overpayment of premiums in the early years of a policy, which must be held, retained as if they were unearned, and accumulated at interest, until later in life when there is a deficiency.

[34] Now, in a retrospective basis, the reserves are defined that way. Life insurance policies, however, can have the reserves defined in a different manner, and that would be prospectively, and that is a method by which you ascertain the present value of your future liability, but you reduce that amount by the present value of your expected premium income. The net is your reserve or your liability. Well, these two, the retrospective and the prospective, would be the same.

Now, that occurs in life insurance. You would have a reserve if the premium payments under these contracts were on a single premium basis rather than on a monthly basis, or even if on some other premium basis than monthly, at the point of valuation ITT Hamilton had received any premium, any portion of which was to cover protection or provide protection beyond the point of valuation.

It just so happens in these contracts, or these reinsurance treaties, the provision is for monthly premium, and the monthly premium is received at the end—after the end of the month for the coverage, so that the premium that had been received at any moment of time was for coverages that had already ceased—had already expired.

Q. Well, I think as I understood part of your definition anyway, maybe it applies to both retrospectively or prospectively, but at least the prospective definition of an insurance [35]

reserve you would say that that would measure the excess of the present value of expected benefits that you would have to pay over the present value of future income or premiums that you expect to receive under the policy?

A. That's correct.

Q. Now, applying that kind of definition, if that's the proper definition, to the treaties here, did ITT Hamilton have any sort of actuarial liability under its Pilot treaty or National Fidelity or Old Republic treaty that should be reflected as the excess of the benefits over the future income?

A. Not in my opinion, because by almost any assumption as to future claims, you would find the excess of their premium expectations from companies like the Pilot and National Fidelity and Old Republic would have exceeded the present value of any probable claims that they would have, so you would have in fact a zero or minus, negative reserve, if you were to try to put a realistic valuation on it.

Q. So from an actuarial standpoint then, in view of ITT Hamilton policy holders and putting them on a sound actuarial basis, would you conclude that there was no need for ITT Hamilton to set up any sort of reserve under these treaties.

A. Well, of course, they weren't ITT Hamilton policy holders, they were Pilot policy holders, but there was no [36] need in my opinion for ITT Hamilton to put up any reserve to protect Pilot Life Insurance because Pilot and the other companies had held in fact the money that gave them this protection.

Q. But from an actuarial standpoint, I take it if ITT Hamilton, under these treaties and especially the runoff treaties, was obligated to pay Pilot and National Fidelity and Old Republic if the treaties weren't canceled, was obligated to pay claims under these treaties, and what I am really asking you is does this obligation, this actuarial obligation to pay claims, should it have been reflected in some way or was it proper from an actuarial standpoint, were they still a sound company even though they did not reflect the unearned premium reserve?

A. Yes, because they weren't obligated in my opinion to pay claims if they hadn't received the premiums from the companies involved.

Q. I see. But if you took these premiums into account, do I understand your testimony to be that the present value of the future premiums to be received under these treaties would at

least equal and would probably exceed the present value of the expected benefits, assuming that the premiums were paid when due?

A. If we were to use the prospective definition, we [37] would define ITT Hamilton's liability, that is precisely what I would say. It isn't normal to think in those terms with casualty type insurance. If you think in the retrospective, you really think in terms of how much of the unexpired period is involved and you set up a proportionate amount of the premium received for that period.

Q. Under that retrospective definition, would your conclusion be any different as to whether ITT Hamilton was required to set up some sort of reserve under these treaties?

A. In my opinion it is just more certain that there was no reserve, no unearned premium reserve.

Q. You mentioned earlier this historical fact, which appears to still be of some significance, that the unearned premium reserve is set up on a gross basis to provide for cancellation in the event of—provided for refund in the event of cancellation of a policy. Did ITT Hamilton, as you need the treaties here, did ITT Hamilton have any obligation to refund premiums to either Old Republic, Pilot, or National Fidelity, or to their policy holders?

A. Not according to this treaty, because any premium refunded by Pilot and National Fidelity and Old Republic to their policy holders was to be deducted from premium payments to ITT Hamilton from those companies, so there was no liability on the part of Hamilton to refund the premium. [38] Pilot, as an example, was to take any refunds that they made out of the premiums that they were going to transmit to Hamilton.

Q. Well, did any part—is it usual to refund—well, let me put it this way. How would you normally compute what would be due to a policy holder or to a ceding company in the case of a reinsurance treaty in the event of a cancellation of a policy, or premature termination?

A. Well, on the credit accident and health insurance, the general rule, under the general practice today, is for the insuring company to refund in the event of cancellation of indebtedness, or—not a pro rata part of the premium but a portion of the premium that had been paid by the policy holder, and is to

determine on the basis of sum of the digits. In other words, he doesn't get a refund of the pro rata portion of the premium he paid, but a reducing proportion.

Q. Does the portion that is refunded represent the earned premium or the unearned premium?

A. The portion refunded in essence represents the unearned premium.

Q. And then let me get back to say just between Pilot and ITT Hamilton, for example, had ITT Hamilton under these treaties received any premiums that it might be required to refund?

[39] A. No, not in my opinion. The premiums they have received is for coverage already expired, and you can't have a refund for coverage already—protection already received. Any refund has to be with respect to the future.

Q. And as far as ITT Hamilton's liability to policy holders, would you say that they had any refund obligation to Pilot's policy holders?

Mr. SCHWARZ. Your Honor, I object to the question. These are repetitive questions. They have been asked before.

The COMMISSIONER. Objection overruled.

A. Not in my opinion, no, sir.

By Mr. SINGER:

Q. Why not?

A. Well, because they have no contract between themselves and the Pilot policy holders. The policy holders are contracted directly with Pilot. It was Pilot's obligation to refund.

Q. Thank you. Mr. Eddy, are you familiar with the terms "reinsurance ceded" and "assumption reinsurance"?

A. Yes, sir, I am.

Q. Would you explain the meaning of these terms in insurance terminology.

A. Reinsurance ceded—it's referred to in other ways than just that, but here I think what you mean is that that's [40] an arrangement similar to the provisions that we have here. It is a contract between two insurance companies and it might be measured—the liabilities that are exchanged might be measured somehow in relation to individual policies of one of the ceding companies, but the contract itself is strictly between the insurance companies.

Assumption reinsurance is quite a different matter and it comes about when companies merge sometimes, or it comes about when one company will acquire the business of another company. The acquiring company, or surviving company in those cases, will issue a certificate of assumption directly to the policy holders of the company that is going out of existence, and it then becomes a contract between the reinsurer and the former policy holders with the former company, and after such an assumption of risk, the policy holders then deal directly with the reinsuring company. They are completely different types of arrangements.

Q. Can you tell us whether the treaties here, the accident and health treaties between ITT Hamilton and Old Republic, Pilot, and National Fidelity, were of the reinsurance ceded type or the assumption?

A. The reinsurance ceded type.

Q. Let's focus for a moment on the ceding companies. We have been talking about ITT Hamilton, but let's talk for a moment about Old Republic, Pilot, and National Fidelity and their situation under these treaties. You mentioned before that a company that has received premiums, which on the valuation date or the statement date represent in part at least insurance that it will have to provide in the future, has to set up an unearned premium reserve. Is this affected—or let me put it this way.

Under the Old Republic and Pilot and National Fidelity treaties, would the fact that these ceding companies have obtained reinsurance affect their obligation or under state law or under actuarial principles, to set up an unearned premium reserve, or could they eliminate the unearned premium reserve since they have obtained reinsurance under these treaties?

A. The Pilot and the National Fidelity?

Q. Yes, the ceding company.

A. Oh, no, they would have been required, as they were, to establish these unearned premium reserves if—incidentally, it is a very elementary concept, simply that they hold the money so they've got to set up and establish the reserve. If they had transferred the money and to the extent that they did transfer the money and any unearned portion of it was transferred at any moment of time, then it became the liability, the responsi-

bility of the reinsurer to set up the [42] reserve, but under these treaties the money was never transferred until after the expiration of the period of coverage. So the Pilot—well, they would have been—they would have been required by the insurance authorities of every state to establish the reserve.

Q. In your opinion, in your experience, have you ever heard of a situation in which a state regulatory authority required a company to set up an unearned premium reserve when they had not received premiums for insurance to be provided in the future? In other words, when they had not received an unearned premium.

A. No, I don't know of any such situation. I don't believe that exists. As a matter of fact, in my opinion the examiners of—all insurance companies are subject to an examination by the insurance departments which regulate them, and this might be restricted to one state, but to tri-state or regional areas if more than one state, but the examining actuaries would check in detail the contracts and policies in force at the valuation dates during this period, and had the company not established liabilities, these examiners would have restated their statements and established such liabilities.

Q. Are you talking about the ceding companies or——

A. In this case the ceding companies, yes.

Q. Well, can you explain in a little more detail how [43] do the state insurance departments keep track of whether an insurance company is maintaining the correct amount of reserves and so forth?

A. Well, through these triennial examinations principally. The insurance companies must report annually on this annual statement that you mentioned earlier, and it describes in great detail the reserves and assets, liabilities and assets of the company, but the real check comes on the examination, which the examiners get into very much detail.

Q. Mr. Eddy, we have stipulated here that, as I have already mentioned, that ITT Hamilton, the plaintiff here, filed its annual statements for '62, '63, '64 and '65, without showing any unearned premium reserves on its business with Old Republic, Pilot, and National Fidelity.

We have also admitted into evidence reports of the examination, I think of the type that you have just been talking about, of ITT Hamilton, audits of ITT Hamilton, dated December 31, 1964, and December 31, 1968.

Based on your experience, do you think it's possible that the insurance authorities having jurisdiction over ITT Hamilton would have taken no action to require ITT Hamilton to set up an unearned premium reserve if it was required under state law or under actuarial principles?

A. Barring an error on the part of the examiner, [44] I don't think so. I think they would have certainly insisted on establishing the reserve if they felt it was required.

Q. Well, I take it that the fact that these statements were submitted every year and that there were two examinations, would make the possibility of error pretty unlikely?

Mr. SCHWARZ. I object. I don't see how he can judge the possibility of error.

The COMMISSIONER. That is speculative, I think, Mr. Singer.

By Mr. SINGER:

Q. Okay. Apart from the field of reinsurance, is it possible for an insurance company to issue an accident and health policy which obligates it to provide insurance to the policy holder for a specific period of time, one year, two years, three years, at a specific premium, and still not—the insurance company would still not be required to set aside an unearned premium reserve?

A. Assuming that the company had not received premiums beyond the point of valuation or premiums representing periods of coverage beyond the point of valuation?

Q. Well, if that is a possibility.

A. Well, I can think of a very common example of that in group accident and health contracts which might be issued on a, say, a monthly premium basis, and the contracts call for [45] coverage, although cancelable, the coverage extends for a year or sometimes guaranteed for longer periods of time. But at the valuation date, which might be many months before the termination date, if the premiums are paid monthly, at the valuation rate the month for which the last premium was received has expired, there is no unearned premium in that case. That is a very frequent thing in the insurance industry.

Q. Suppose in this case, ITT Hamilton had issued a policy which provided for accident and health coverage as well as life coverage, over the period of the loan, and issued it to an individual debtor and charged the debtor a monthly premium, equal to, say, the monthly earned premium, which it received at the end of each month. Would it in these circumstances have been required to set up an unearned premium reserve?

A. No. As a matter of fact, there is that type of coverage in existence and it is frequently sold through savings and loan associations, but the insurance companies do not establish unearned premium reserves if it is on a monthly basis and the valuation date coincides with the expiration of the month or the monthly coverage.

Q. And these policies would be actuarily sound if you received the premium at the end of each month equal to the earned premium. Would there by any actuarial reason why these [46] policies would not be sound?

A. No, not generally.

The COMMISSIONER. Off the record.

[Off-the-record discussion.]

The COMMISSIONER. We will take a ten minute recess.

[After a recess, the hearing proceeded.]

The COMMISSIONER. All right, Mr. Singer, proceed.

Mr. SINGER. Thank you.

By Mr. SINGER:

Q. Mr. Eddy, I believe we spoke before, in our discussions about the unearned premium reserve, about the gross—we mentioned the gross unearned premium reserve and the fact that this contains a loading element and a morbidity element.

Now, Mr. Eddy, do you have an opinion as to whether it would be appropriate to compare a life insurance reserve with an unearned premium reserve, a gross unearned premium reserve, if the purpose of the comparison was to measure the risk assumed by a company on life policies or life benefits as opposed to the risk assumed by the same company on accidental and health benefits?

Do you have an opinion as to whether this would be appropriate?

A. Yes, I have an opinion. I think that that wouldn't [47] be appropriate if you restrict it to comparing the risk, to measuring a risk, because the gross premium obviously is for more than just the cost of carrying the insurance risk. It has to be for other purposes, too, as I have already mentioned.

Life insurance, by definition, is so-called risk only reserve and it is measured by statutory standards, but it is still something different from the gross premium, generally speaking.

Q. Is there a comparison that could be made that would be meaningful, to show what the dollar value of the life risk

of a company was, as opposed to accident-health risk, that could be used?

A. Well, if you used the morbidity element only in the accident-health and the mortality element only in the life, of course, you have to recognize interest to the extent of the period of coverage. Taking those things into account, you would have, at least to the extent you can compare the two benefits, you would have something comparable.

Q. Thank you. Mr. Eddy, have you examined the policies submitted by parties as Exhibits #10 through #16, which we submitted as typical individual and group credit life and credit life, accident and health policies, reinsured by ITT Hamilton during the years mentioned?

A. Yes, sir, I did.

[48] Q. Some of these policies provided both life, accident and health benefits in the same policy. Is this type of policy sometimes referred to in the insurance industry as a life insurance contract combined with accident and health insurance?

A. Yes, I believe you would consider that a combined contract.

Q. Could you go into some more detail as to what are the characteristics of a combined policy and the kinds of policies that have been issued and called combined policies?

A. Well, there is a great variety of these in the individual life insurance field. In the early part of this century, the companies frequently issued contracts that combined life insurance and an accident and sickness type of benefit. Those coverages would pay the face amount of the policy in the event of death, or if the man became disabled, they would provide for an installment of the face amount over a period of years.

Now, conceptually that's the same sort of contract that we are talking about here. In one event, that is, death, they pay the balance of the loan, and in the other event, in the case of disability, they would pay the balance of the loan in installments. So that type of policy has been in effect at least since the early part of the 1900's—the [49] combined type of policy.

The particular disability benefit somehow was not favored by insurance companies during the depression years as there was a great deal of abuse, at least they thought so, of that benefit, so that type of coverage sort of disappeared from the scene until, say, in the last fifteen or twenty years. It has now reappeared, but that's one type of combined policy.

In the weekly premium industry field you have a combination frequently of life insurance policies with other types of accident, sickness, sometimes hospital benefits, sometimes income benefits. The most striking, conceptually, is combined credit policy and the policy I described as being in existence in the early part of the century. They are the same. The only thing different is the period of time covered.

Q. When did these weekly industrial policies, if you know, when did they appear on the scene?

A. They have been in existence most of this century, too, and still are, for that matter.

Q. Mr. Eddy, do you agree with the statement that the term "non-cancelable life, health or accident insurance policy" means a health and accident contract or an annuity contract which the insurance company is under an obligation to renew or continue at a specified premium and with respect to which a reserve in addition to the unearned premium reserve [50] must be carried to cover the obligation? Is that an accurate definition?

A. Well, that's not my definition, but I believe a guaranteed renewable or non-cancelable contract is one which the company cannot cancel. I don't think that the reserves per se have anything to do with that definition.

The industry, through the National Association of Insurance Commissioners, has come to believe in the last couple decades that there is some need to set up an additional reserve for long-term non-cancelable life and health policies to recognize the fact that you are committed to a fixed premium.

Guaranteed renewable is not a fixed premium, but you are committed to continue, and this additional reserve they believe necessary to recognize the deterioration of health as age advances, so it is like the ordinary life insurance policy, where the premium is redundant in the early years, you must hold some back.

Now, the Insurance Commissioners did establish a definition which would divide policies or create a clear-cut line as to when they would require companies to set up an additional reserve, and when they would not, and this has become their definition of non-cancelable. As far as my understanding, it has to do not with reserves or whether the company can cancel or not.

[51] Q. What was the purpose of the Insurance Commis-

sioners drawing this line and saying certain policies are cancelable and certain are non-cancelable?

A. It is a recognition that came into existence of this potential need for additional reserves. This is all relatively new, of course, because the insurance companies generally discontinued accident and sickness insurance on a non-cancelable basis during the depression years because of the abuse that I was talking about, but after the war the competition has driven them back to issuing all sorts of such contracts and, of course, each and every year the commissioners become a stronger organization, as far as regulating, keeping the insurance companies under a statutorily solvent basis, so they have promulgated these regulations requiring extra reserves.

In my opinion it is an arbitrary provision because I think the rule goes something like age fifty, fifteen years, but they might just as easily have said fifty-five or forty-three or five years or twenty-five years, but it is a rule which they go by—most of the industry goes by.

Q. If an insurance company issued a policy for three years, providing accident and health benefits, does the risk assumed by the insurance company deteriorate during that period on an actuarial matter during the three year period?

[52] A. Unfortunately there is a deterioration as we age with respect to health and life, but generally speaking, it is the younger middle-age range—there is a deterioration, of course—it is very minor at those ages. but there is some deterioration.

Q. Would the company have to take this deterioration into account in setting the premium for a three-year accident and health?

A. Well, in my opinion I don't think so. I would suspect not. It would depend on age, of course. If the age were sufficiently advanced, maybe so, but generally I'd say no.

Q. Mr. Eddy, I would like you to tell me whether the following definition of a deficiency reserve is in accord with the accepted definition in the insurance industry: Quote, "The deficiency reserve for any contract is that portion of the reserve of such contract equal to the amount, if any, by which the present value of the future net premiums required for such contract exceeds the present value of the future actual premiums and consideration charged for such contract."

Is this consistent with the accepted meaning of this term in deficiency reserves in the insurance industry?

A. Right, with the additional provision there that we are talking about statutory future premium requirements as opposed to actual premium expectations or actual premium [53] charges. Yes, I think that is what it is understood.

The COMMISSIONER. I didn't hear you, Mr. Eddy.

The WITNESS. Well, as he read this definition, I failed to hear the reference to the statutory requirement for future net premiums in establishing reserves, and this deficiency reserve came about in about 1930 or along in that period of time, when stock companies began to sell insurance, where they charged the customer a premium that was smaller than the statutory net premium that is required to accumulate the reserves, and, of course, this came about because during that period of time the entire insurance industry, the life insurance industry, was using a mortality table which had been constructed or compiled in 1846 by one of the large mutual companies, and when constructed, it included certain measures of conservatism, and obviously, was quite outdated by the 30's.

So the stock companies, in their competitive efforts to get business from each other and from mutuals, would charge a smaller and smaller premium, adequate based on current mortality, but deficient compared to these redundant old, outmoded mortality tables. So deficiency reserves appeared in the statutes gradually and now exist in all—the statutes of all states as part of the standard valuation law.

To cause a company which sells to its customers an [54] insurance policy with an annual premium smaller than the statutory net premium, then the company is required at the moment of sale to set up the present value for the rest of the premium paying period of that deficit.

Of course, it's considered by almost everyone familiar in the industry, familiar with the industry, including the Internal Revenue Service, as not really a reserve but as setting aside or earmarking some part of surplus.

For instance, you cannot treat this deficiency reserve as—take it as a deduction from your taxable income, nor can you take investment income on it as a required interest to maintain reserves, and it's generally considered that way, but when he read this definition, I didn't get the word "statutory net premium requirement," and that's what I was trying to make clear.

By Mr. SINGER:

Q. So it is the difference between the present value of the statutory future net premiums and the actual—the present value of the actual premiums?

A. Right.

Q. Okay. Is it possible that a regulatory agency might require a company to set up a deficiency reserve on a single premium life insurance or annuity policy where the single premium is paid on the first day of the policy?

[55] A. Well, not by definition because the present value of future net premiums is zero and the present value of future gross premiums is zero. As a matter of fact, when companies are required to establish this deficiency reserve, this present value of the difference over the premium paying period, the reserves that sits on the books at the outset consists of the sum of the life insurance reserve plus this deficiency, and as each year passes towards the end of the premium paying period, a portion of the deficiency reserve is reduced as the life insurance reserve is increased.

So finally at the end of the premium paying period, under the deficiency requirements, deficiency reserve requirements, the deficiency reserve becomes zero and the life insurance reserve then is the total and only reserve required by law.

Q. Is there any analogy between the deficiency reserve and the loading portion of the unearned premium reserve?

A. No, I don't recognize any analogy between those two.

Q. Okay, thank you.

Mr. SINGER. That's all.

The COMMISSIONER. Are you ready to proceed, Mr. Schwarz?

Mr. SCHWARZ. Yes.

The COMMISSIONER. All right, proceed.

[56] Mr. SCHWARZ. With your permission, I would like to remain seated during my cross-examination.

The COMMISSIONER. You may, certainly.

CROSS-EXAMINATION

By Mr. SCHWARZ:

Q. Mr. Eddy, during the early part of your examination you discussed with Mr. Singer the kind of situation where a company assumes insurance in force but has not yet received the premium for that insurance.

Could you discuss with us, and one of the examples of that is this treaty with National Fidelity and with Pilot and with Old Republic—could you review with us each of the situations in your experience, besides the ones involved in this case, where that situation has come up and where you have considered the meaning of the term "unearned premium" or "unearned premium reserves" in that context.

A. Well, if I understand your question correctly, this involves maybe several dozens of companies, but to try to give you an illustration, I will name some specific companies, if that will be beneficial to you.

There has been—well, in recent times, at any rate—the requirement of most insurance departments in this country, that the reinsurer had to be qualified, or sometimes licensed in the state in which its companies who were [57] reinsuring with such reinsurer were domiciled.

Now, a lot of reinsurance is purchased through European markets and European reinsurers. Not all of them, some of the larger ones, have been licensed here for many, many years, but many of them also have not been, and in order to circumvent the problem which is created by the domestic company reinsuring, say, on an annual premium basis with a foreign nonadmitted reinsurer and being denied the deduction from its reserve liabilities the unearned premium held by the reinsurer on account of the unexpired portion for the period of time involved, at the risk it had reinsured, European reinsurers offered to sell reinsurance on a monthly premium basis.

Well, that practice has been adopted by a number of companies reinsuring in this country, and in fact, one of the most recent entrants into the reinsurance market is a company known as the Provident Mutual—excuse me, the Phoenix Mutual, in Hartford, and they have been in the business quite a few years now, and I don't know how many customers they have. Many of my clients bought reinsurance with them, but regardless of the premium payment basis between the client companies and their customers, with the policy holders, they reinsured and paid premiums to the Phoenix and Occidental of North Carolina, Victory Life, Occidental of England—many others [58] I can't think of on the stand here—they reinsured on a monthly basis.

Now, the reinsurer was not—although they were committed to the contract and they couldn't cancel the contract, they had

no unearned premium reserves beyond that month's premium. Their valuation date fell, as it does, on December 31, and their premiums were collected throughout the month of December. They would have had a half of one month's premium as a reserve, but this is a common practice and the type of reinsurance you are talking about here, where in effect you have a combination——

Q. Excuse me. Are you going back to these policies now?

A. Yes.

Q. Could I just talk to you for a moment about the example you have given? I will try to take each one separately.

A. All right.

Q. You mentioned that the practice that you just described arose because of the requirement in many states that the reinsurer be licensed or qualified to do business in the domiciliary state of the insurer; is that right—in order for the insurer to get credit for unearned premiums transferred to the reinsurer?

A. In order for the credit to be given, that's right, [59] yes.

Q. Now, does this suggest, first of all, a practice whereby an insurer who, at least to use your opinion of the situation, pays the full premium on reinsurance at the outset of the coverage to a reinsurer, will be allowed a credit for its unearned premium reserves by the insuring state, if in fact that reinsurer has been qualified to do business——

A. And if there is a premium transfer.

Q. I said the premium would be transferred.

A. In the event the premium was transferred, then that's right, yes.

Q. Okay.

A. Of course, there were other reasons for this type of reinsurance, which you can appreciate, other business reasons. For instance, the reinsuring company—and I hope I don't inadvertently use terminology which is exactly opposite from the way you are thinking, but the company ceding, obviously, would be more pleased if it could collect premiums on an annual basis from its policy holders and remit monthly to the reinsurer.

Q. Would pay for that?

A. Well, competition in fact keeps it down to a minimum cost, if any, or it's not measurable. It's not anything direct or obvious. And because of the cash flow—and this [60] is particularly true with smaller companies, and their images mean a lot to many life insurance companies, if not all of them—

they like to see better balance sheets and better cash balances, so this is one of the reasons.

Q. Now, if the effect of the credit that you referred to would be that the unearned premium reserve which, before the reinsurance, had to be held by the insurer, would be deleted on its annual statments, and the reinsurer, in the example I gave you, would be required to reflect an unearned premium reserve on its annual statement——

A. And you referred to the example you gave, emphasis on the fact that it was an annual premium from the ceding company to the reinsurer.

Q. Yes, that's the example I gave.

A. That's right. Of course, I have to qualify that and say that in the event that the period of coverage for which this premium had been paid had run, there would be no unearned premium, no credit either way, no credit nor reserve.

Q. Now, in the same example that you gave, suppose the reinsurer were not qualified to do business in the state, or were not—or it was not licensed to do business in this state. Would the insuring state permit a credit to be given?

A. Well, you have to accept this as a hypothetical answer to a hypothetical question because generally companies [61] are too smart to deal with reinsurance with which they can't get credit. But assuming this could happen, then the ceding company would be denied the deduction for reserves held by the reinsurer.

Q. And would the domiciliary state of the reinsurer require it to reflect an unearned premium reserve on its annual statements despite the fact that the insuring state also showed an unearned premium reserve because of the denial of its credit?

A. That situation can exist if companies would do it, that would be true. No, I am not sure I am answering the question right. I will state it as it should be. The reinsurer would have to establish the reserve because in the insurance industry the liability for an unearned premium reserve depends on whether you've got the money or not, and in the case, the illustration you were giving, the reinsurer has received the money, so from a mathematical or equitable point of view, they have the unearned premium reserve no matter whether the ceding company could have taken credit or not.

Q. So the situation does exist then when two unearned premium reserves could exist?

A. Oh, I can't say it exists.

Q. Well, it could exist?

A. It depends on the business acumen, of the people [62] involved, but I would say generally that doesn't exist in practice. It could exist in theory.

Q. Why would an insurer be interested in obtaining a credit for its unearned premium reserve besides the—I suppose the most obvious fact is that it doesn't have the premium—I assume that would be the first part of it. Besides that?

A. Well, of course, despite the fact that the insurance industry is regulated with an emphasis on protection of policy holders and, therefore, reserves are normally established at a very conservative level. There is an endless effort on the part of all parties involved to properly account in your balance sheet for your liabilities and for the other guy's liabilities. Now, in spite of—ignoring anything else, it would be, accounting-wise, totally inaccurate not to take credit if in fact the reinsurer had taken the premium and it was responsible for holding the reserve.

Q. Apart from the questions of forms involved in accounting, what substantive reasons might an insurer rely upon? Why might it want to rid itself, so to speak, of an unearned premium, especially if the effect would be to increase surplus, as it would in the example that you gave?

A. Not necessarily, it can and it cannot, but the example I was thinking of, as I spoke—I didn't visualize any surplus. As a matter of fact, generally speaking, we are [63] talking about the reserve carrying an insurance risk on an unearned basis. What you are really doing is, if you transfer the reserve from one company to another, it's a result in practice of transferring an asset, namely, the premium. So if the guy that has the asset, he also holds the liability. At the moment of transfer on the cost of carrying the risk basis only, they are exactly the same. The amount of money that you pay is exactly equal to the reserve at that moment, so there is no gain or loss in that situation.

Q. I am not referring to gain or loss necessarily, but tell me what the normal effect is on an insurer upon—on an insurer's assets, reserves and surplus, of reinsurance of busi-

ness. Now, let's take a—if "normal" bothers you, we will take what I would hope would be a normal example, and correct me if I am wrong. An insurer receives—agrees to reinsure, let's say, three year straight age policies, and it receives all the premiums, three years worth of premiums for those policies at the outset of coverage. It then enters into an agreement with the reinsurer whereby it reinsures 100% of its liability with the reinsurer and it pays the reinsurance premium, which I would think in a normal case would be—and it would be in this case—would be something, say, a little less than the original premium to provide a commission of some sort for the insurer,—pays that amount to the reinsurer, [64] at which time the reinsurer assumes the liability on the risk for the three or four years, whatever the policies are. Now, in connection with that transaction, the insurer would normally pay commissions to the agents who brought in the insurance, isn't that right?

A. The ceding company?

Q. Yes.

A. I think you are using the term "reinsurer" interchangeably and it is confusing me.

Q. I will use ceding company.

A. Okay. If you are talking about the ceding company, there are different circumstances—there are occasions when insurance companies get business without commissions, but the normal case is that a commission is paid, yes.

Q. Okay. Then we will pursue this normal example. The commission that would be paid would—is usually a significant portion of the premium. I realize it can range over quite a broad spectrum, but it is significant and it is paid at the outset of coverage in my example, is it not?

A. Now, the word "significant" needs to be qualified if we are talking about different types of insurance. For instance, the customary commission on single premium life insurance is in the neighborhood of two or three per cent. If you are talking about annual premium, which is in effect [65] another way of paying the single premium, companies make it convenient for people who are buying insurance by making an annual premium basis available. Then the commission, a percentage of the first premium, is substantially more. It may be in the neighborhood of fifty, it may be even a hun-

dred per cent in many of the stock companies, taking all levels of salesmen into account.

That is still, if you would take into account all of the premiums, although it's a large percentage of the first one, you are still talking about maybe something averaging quite much more over the entire period of the contract since renewal commissions are substantially lower, but I just want to make it clear that—you said it was a wide range, and there is, of course.

Q. Are you aware, for example, that the commissions involved in the Pilot and National Fidelity treaties and those paid by the insurer were between twenty and thirty per cent of the premium?

A. Well, I don't have that fresh in my memory, but I have read those agreements.

Q. Well, they weren't in the treaties, nor in the policies. That's why I ask you now. I understand——

A. Whatever was in the treaties, I suppose that's the only thing I have to go by.

[66] Q. We talked about stipulating those figures.

Mr. SINGER. Mr. Eddy doesn't know those figures. We haven't stipulated to them, and they are not in evidence.

By Mr. SCHWARZ:

Q. Okay. So a commission, whatever it would be, would be paid at the outset. What might be the commission, a typical normal commission on a three year age policy? What would its percentage be of the total premium?

A. I don't know that there is any normal, because you have a complete range from zero to—I would expect on accident and health—generally, and accident and health credit insurance—is this what we are talking about?

Q. No, regular accident and health policy.

A. Not restricted to credit?

Q. That's right.

A. Well, then probably the range could be from zero to thirty-five—forty per cent.

Q. Okay, let's say it's twenty per cent for the purposes of the example.

A. All right.

Q. So the insurer, the ceding company, pays a commission of twenty per cent. It receives a premium of a hundred per

cent, remits a reinsurance premium to the reinsurer, which is somewhere in the vicinity of a hundred per cent, maybe [67] ninety-eight, maybe it's ninety-seven—something like that. Now, given that example, what is the effect on the assets, reserves and surplus, of that transaction, as far as the ceding company is concerned?

A. Well, in the example you are giving here, let me restate it to make sure I understand it. The ceding company has held a policy and it's received a premium, a three year premium.

Q. Okay.

A. Then it has paid a twenty per cent commission, you say? Then on its books immediately it would have had, in the income statement, income of—let's make it a dollar premium, for convenience—a dollar premium income, a twenty cent disbursement for commissions, and if it is an accident and health coverage, the statutory reserve would be a dollar reserve. So as far as the income statements are concerned, we've got a net loss of twenty cents. The balance sheet would show assets of eighty cents, liabilities of a dollar.

Q. You said there would be a loss of eighty cents?

A. A loss of twenty cents.

Q. You have a dollar of income on the income statement, less twenty cents commission, that would be an income in effect of eighty cents.

A. Net income, yes.

[68] Q. All right. Now, the asset would be eighty, the reserve would be a dollar?

A. Right.

Q. And the effect on surplus would be what?

A. Well, as I have already said, your loss would be twenty cents and your balance sheet would show a dollar and eighty cents respectively, thereby surplus would be minus twenty cents.

Q. Okay. Now, what is the effect on that statement of reinsurance under the example that I gave you?

A. Well, there is a difference in practice in the United States. It's not clear-cut at the moment, in my thinking, as to where it is going to end up. At the moment some states would require one of——

Q. I am asking for the normal practice. I realize there are always differences.

A. I can't say. It may be pretty evenly divided between the states at this moment of time.

Q. Was it divided during the years in suit?

A. As a matter of fact, more specific than the years of this suit, I believe the prevailing practice was this, that the ceding company would have reinsured the risk and the reinsuring company would have received—let's suppose a hundred per cent for the sake of argument. Barring any sort [69] of compensation to the ceding company for the moment, the ceding company would have reinsured, say, a hundred per cent of the risk. They would have transmitted to the reinsurer eighty cents, and the reinsurer would have established as their liability on the basis of their gross, an eighty cent reserve. So there would be no gain or loss to the reinsurer at that moment, and there would be no change in the account of the ceding company.

They would be out—their balance sheet would be different because they would have eighty cents less assets, but they would also—I beg your pardon—it would have made a twenty cent increase in their net worth because they would have got rid of a dollar reserve with the eighty cent premium.

Q. Is their practice whereby the reinsurer would set up an unearned premium reserve for one dollar rather than eighty cents?

A. Subsequent to the time that you are talking about, there has been concern amongst the insurance commissioners to the extent that it is generally accepted—I am not certain, but there has been a change of practice which has required the reinsurer in the example we just talked about to establish a dollar reserve rather than eighty cent reserve. But during the period of the time of this case, it was really the other [70] way around.

Q. Are you familiar with the examiner's handbook of the National Association of Insurance Commissioners?

A. Somewhat, yes, sir.

Q. Are you familiar with the Section B in that handbook on reinsurance?

A. What page number?

Q. Well, if you are familiar with the section, we can then become more specific as to the page.

A. I am familiar with the section.

Q. This is a Section B, is a reference from the 1961 NAIC proceedings, Volume 1, pages 147–177.

Mr. SINGER. Excuse me. Is there any way we can have a copy of that, or see what he is talking from?

Mr. SCHWARZ. I am not offering this into evidence. They can see it if they would like. I am just asking—stating something from it, and asking whether he is familiar with the statement. Now, if they want to review it, they are quite——

The COMMISSIONER. For convenience, you don't happen to have an extra copy, do you, Mr. Schwarz?

Mr. SCHWARZ. Well, I believe——

The WITNESS. I would be glad to have a copy, too.

Mr. SCHWARZ. Does opposing counsel have a copy [71] elsewhere?

Mr. SINGER. I don't think we have it here.

Mr. SCHWARZ. The copy that I have is——

The COMMISSIONER. Off the record, Mr. Reporter.

[Off-the-record discussion.]

The COMMISSIONER. On the record now, Mr. Reporter. We have been off the record while you were discussing the copies.

Mr. SCHWARZ. Perhaps Mr. Eddy would want to ask again what he thought I was doing.

Mr. SINGER. Could I ask that the witness be shown this?

Mr. SCHWARZ. Certainly.

Mr. SINGER. The one you are referring to.

[Article referred to the witness.]

By Mr. SCHWARZ:

Q. I was referring to this heading on page B–14, and I am asking you about this sentence which is my understanding of what the normal practice is, and it seems to differ, if I understand you, from your statement of the normal practice.

A. Now, without reading it, and I think I am familiar with it, you are talking about excerpts from proceedings of '61. Well, these things take many years to become enacted as either statute or become regulations in the various [72] individual states that are involved, and I don't find, as I say, subsequent to the period in question here, it is my belief that states generally have been accepting this proposal of the NAIC.

Q. This was not a proposal, this was a statement by way of information of what the normal——

A. That has not the effect of regulation, that's just what they collectively think they should do. It's quite another matter for them to go back to their home states and to implement these common understandings. In fact, in many cases where they have requirements of statute change, you can't do it immediately because states only have their legislature in sessions biannually, so when it appears in their transactions in '61, it doesn't mean it was immediately effective.

I just happen to know, from my own personal experience, what the practice was in 1963, and I do know for a fact that some states that I happen to be interested in, in my occupation, made a transition during that period of time, and in fact the companies that I have been involved with during that period of time, but I also know in general it hadn't become effective.

Now, to answer you as if these proceedings had become effective regulations throughout the country, then [73] the fact of the transaction that we were talking about would have been to have given the ceding company a twenty cent increase in the surplus, probably reflected as income, depending on how it was handled accounting-wise.

Q. Okay.

A. And likewise, the reinsurer would have had a twenty cent decrease in surplus because it would have received presumably the eighty cent premium for which it established a dollar reserve.

Q. Okay. So would an insurer or ceding company interested in increasing its surplus for any reason insure under the example that I discussed with you, presuming the state that we are talking about does grant the credit, presuming the effect to be of increasing the surplus by twenty cents, as you stated in your example,——

A. Would the ceding company be interested in anything other than such transaction that we discussed?

Q. Yes, I am just affirming what I understood you to say before, that an insurance company, desirous of increasing its surplus, might do so under an arrangement which we have just discussed.

A. Yes, but, Mr. Schwarz, I feel compelled to point out to you that what we are discussing as increasing is not anything real.

[74] Q. I am not concerned with the reality, I am asking you——

A. Well, but I can't answer the question in that context. I have to say it as I see it.

Q. I am asking you to tell me whether the company, after doing this in a state which permits it, could then show an annual statement or a financial statement which would have a higher surplus than it did before.

Mr. SINGER. Excuse me, Your Honor. We have gone along with this for a while. I submit I don't understand where this is going. This doesn't relate, as far as I can see, to the treaties between ITT Hamilton and the ceding companies in our case, and I would like to object at this time, unless Mr. Schwarz can tell us where he is going as to the relevancy of this line of questioning.

Mr. SCHWARZ. Your Honor, plaintiff's direct examination covered the entire insurance industry and discussed examples ranging from life insurance to industrial accident insurance. I am also pursuing industry practice, and I am asking about a particular industry practice at the moment, and in that context I am discussing the effect of the practice on unearned premiums and unearned premium reserve, which I believe is a rather crucial point in this case.

The COMMISSIONER. All right, objection overruled.

A. Well, that practice wasn't common. You have to [75] understand that because whereas——

By Mr. SCHWARZ:

Q. Mr. Eddy, I am asking you a specific question and I would like to get a specific answer. The question was under the arrangement that we just described, the example that I just posed and that you clarified, if a company desired to increase its surplus on its annual statement or on a financial report, could it not do so by twenty cents if it followed this example?

A. Well, I have already answered that, I believe.

Q. What was your answer?

A. Well, to repeat myself——

Q. Can it or can it not?

A. I said it increased to twenty cents.

Q. Okay, fine. Now, getting back to the first example you gave in response to my question about the various contexts in which a premium had not yet been received by a company which had accepted insurance in force, could you describe in somewhat more detail the kinds of reinsurance treaties you were referring to, and again a little bit about the kind of insurance that was being reinsured under these treaties.

A. Well, I believe that during my experience, I have probably seen many insurance agreements that covered all types of life and accident and health insurance, and I may be hard pressed to name by individual companies at this moment where [76] they did exist and did not exist, but I have seen many contracts of individual policy life insurance and individual policy accident and health insurance, credit insurance, both individual and group, both life and accident and health, reinsured on a basis similar to what we are discussing here with respect to these companies, namely, that the premium arrangement between the ceding company and the reinsurer was on one basis and the premium basis between the ceding company and its policy holders was on another basis.

Q. Okay. Well, let's go through the various types of insurance that is covered and the various types of reinsurance treaties that would result under those forms of coverage with a view toward describing basic terms most simply. You started off with an example of individual life policies, which are then reinsured. Could you describe the basic elementary terms of these life policies first?

A. Well, they would range from—well, the entire type, range of types of policies, individual, ordinary life insurance or whole life insurance, which implies that the coverage is for the entire life of the individual insured.

Q. Let's take that example.

A. All right.

Q. Under that example, does an insured normally, if you will, pay an annual premium in order to purchase a whole [77] life policy which will provide him with the face amount upon his death?

A. Well, "normally" is a difficult question to answer. Very frequently the insured does that, yes.

Q. Is the premium normally stated on an annual basis? If I go to an insurance agent and I say, "I want to purchase a whole life policy for $100,000, what's the premium?"—what is he going to say?

A. Well, I think invariably the premiums are stated on an annual premium basis. Other plans are offered.

Q. I understand that. Let's take the case of an insured who takes out a whole life policy with an annual premium. When does he pay that premium? He is not paying it in installments now, he is not electing, as I understand he would be able to. When would he normally pay the premium?

A. Well, the premiums are due when they issue the contract.

Q. They are due when the contract is issued?

A. Right.

Q. I see.

A. Of course, there are provisions today required by law which give the man subsequent premium payments after the first, a grace period.

Q. Okay, let's not move too fast. We are just talking [78] about the first premium now.

A. With respect to the first premium, it is the general practice that insurance companies in fact do issue the policy and they do become committed to the risk in a contractual arrangement at that moment of time, and then the policy holder pays the premium whenever he receives his policy. There could be a lapse of time of several weeks—maybe thirty days.

Q. We are talking about a short period of time that arises in practice between the time that the premium is required to be paid and the time that it is in fact paid, in practice.

A. Right. Currently the competition on new policies of this period of about forty-five days, that's pretty common today, and then through practice companies allow for maybe another couple of weeks, and this is more for administrative purposes or convenience than anything else before they actually implement the lapse process.

Q. Does a binder take care of something of this——

A. You can have binders and you can have other—you can have insurance issued without—you are talking about a binding receipt, some money received at the time of the application—is that what you mean by that?

Q. Yes.

A. It's issued both ways.

[79] Q. All right. So in a typical case the premium is required at the start, the annual premium is required at the time the policy goes into force, and again it may be paid a little before, a little after, depending on the practice. Now, at the end of the year the company sets up a life insurance reserve. How does it measure that reserve?

A. Well, it measures this life insurance reserve either by the prospective or the retrospective method, which I have mentioned before.

Q. You don't have to repeat it.

A. You don't want me to repeat that?

Q. No.

A. All right.

Q. Now, what happens if the policy holder does not pay his annual premium at the beginning of the following year or within the grace period that is allowed under the policy?

A. His policy is canceled.

Q. Is he advised of this?

A. Generally speaking, yes.

Q. You mean he might not be advised?

A. He's got to be advised because his contract says he has to pay it within the grace period.

Q. The policy?

A. Yes, there is a provision in the policy that [80] terminates it. The companies, through practice, may or may not notify the insured. There are non-forfeiture benefits, and if the policy has been in force long enough that it has a refund benefit, a non-forfeiture benefit, then the companies would put the man on notice that at the expiration of the non-forfeiture benefit—that's, of course, to make sure he understands his coverage has not ceased.

Q. Okay. Now, this type of policy can be reinsured?

A. Yes.

Q. Is that correct?

A. Yes.

Q. Would you describe the basic terms of a reinsurance treaty, for the reinsurance of this particular policy. Again we have talked about an average, a normal whole life policy, and I am asking you now about a normal reinsurance treaty, or if there are a couple of varieties——

A. Well, there are more than a couple of varieties.

Q. I am sure of that.

A. The most common would be—well, generally speaking, reinsurance serves the major purpose of spreading the risk. It really, in the life insurance industry, is never considered a transfer of the liability on any permanent long-range basis. People would be naive to think that reinsurance companies were in business other than to make a profit.

[81] So that what they are doing is they are offering a service, a service which is to level out claims rather than have a company experience, say, a chance fluctuation and an unexpected large claim.

Q. Why aren't they long-term arrangements? I didn't understand your response there.

A. Well, in the long-range, all insurance companies, unless they fold up before the things level out, pay their own claims. The direct policy holders ultimately are paid out of the funds of the issuing company.

In interim periods of time, through reinsurance, unless we've got an assumption of the risk or we have co-insurance, which is a variety we haven't been speaking of here, the reinsuring companies only in effect are leveling out the claims experience of the ceding company.

Q. Would the normal provision of the reinsurance treaty permit the—when the insurer, the ceding company, got large enough, say, to be able to assume the risk which it's reinsured, how would it go about doing that in a normal situation?

A. Well, there are differences in practice there. Competitive pressures generally cause companies in recent times to assure the ceding company that they could recapture these risks under certain terms and conditions after certain periods of time have run. Of course, the main purpose there [82] is for the reinsurer to make sure it has had an opportunity to recover and not have to have a recapture right after the occurrence of some big claim.

Q. So the reinsurer might be able to cancel his reinsurance for some future period, for some future year?

A. Are you talking about the ceding company now?

Q. Let's say the ceding company pays an annual premium to the reinsurer much the same way as the policy holder paid an annual premium to the ceding company.

A. Yes.

Q. When the next premium became due, under a normal situation, the reinsurer would be able to cancel by not paying the premium; is that right?

A. The ceding company?

Q. The ceding company.

A. If the policy is lapsed, you are saying?

Q. Yes.

A. Or referring—yes, it would—it's all automatic and by agreement. The terms of the agreement say that when the ceding company's liability ceases, the insurer's liability ceases.

Q. And normally it would be able to cause the policy to lapse by failing to pay the premium, or giving notice?

A. Or terminating for other reasons.

[83] Q. Okay. Now, since that is the case, a reinsurer would not assume expenses beyond those which he could expect to be compensated for in some way or another out of premiums he received, an annual premium, is that it? For example, for some strange reason if the ceding company paid the agent the full commission that he would earn if the policy holder continued paying his premiums for his full life at the outset, a reinsurer is not going to agree to pay that commission to the ceding company, pay it back to the ceding company or to have the premium which it receives reduced by the amount of the lifetime commission, when it's only receiving one year's premium?

A. Oh, yes. You see, we are talking about life insurance. I think you've got a misunderstanding because in life insurance, generally what you are reinsuring is the mortality element only, so the premium that you are transmitting from ceding company to reinsurer is not the gross premium but it's the cost of carrying the insurance risk.

Q. So it is the current premium?

A. I beg pardon?

Q. It's like a current premium, right? It's a premium covering the period—in other words, it's the current portion of the premium and not the portion that has to be set aside to provide for risk which is going to arise in the future, [84] that is, the reserve portion.

If I get a premium—if I am a ceding company and I get a premium of a hundred, I am required—some part is expenses, some part is put aside as a life insurance reserve, is that right?

A. I need to go back if I could to this concept of the arrangement between the insured and the ceding company, is on one basis.

Q. Yes.

A. The arrangement between the ceding company and the reinsurer is on another basis. Now, the arrangement between the ceding company and the reinsurer, on a normal reinsurance of life insurance, is only to deal with the cost of carrying the insurance risk generally in some amount above what the ceding company considers its safe level of risk.

Q. I see.

A. The amount above that safe level is the amount of reinsurance for which the ceding company pays the reinsurer, not of a premium that has any redundancy in it, which the reinsurer then is obligated to accumulate with interest on the same basis that the issuing company is accumulating excess premiums in the early ages from its direct policy holders, but only the premium that is necessary for the period of coverage for which the premium is intended.

[85] Q. I see.

A. On an annual basis if it is annual, a monthly period if it is monthly.

Q. Now, this example you are giving me is typical of the kinds that you referred to in your first example in response to my introductory question? Is this one of the examples?

A. Well, this is one of the examples, and originally what I was referring to was the modes of premium payment and not the types of insurance.

Q. Well, you were referring to a particular type of mode in the example when you first responded to my question; is that right? The types of modes. Was the example that we just discussed one type of those modes?

A. The mode to me refers to the method of premium payment.

Q. That's right.

A. Okay. I was explaining a reinsurance arrangement which could encompass different modes and not specifically in this discussion talking about a particular mode.

Q. My question was, my original question was that I wanted you to review in specific detail all the various types

of situations you have come across, or convenient examples of all of them where a premium had not yet been received, [86] although insurance was in force with the company that had not received the premium. Now, that's not the case in the example we just discussed, is it? The annual premium is received at the beginning of the period, isn't that right?

A. Mr. Schwarz, I think I may be confused by your questions. The explanations of reinsurance, which I was attempting to give, didn't have to do with the timing of premium payments or the mode of premium payments. There are all sorts of arrangements that exist in practice. About the only thing that doesn't exist is the payment of premiums by the insured after the period of coverage is expired.

Q. Do ceding companies pay reinsurers after ceding?

A. Between corporations, all sorts of arrangements exist, and timing is something that is a mechanical problem with most insurance companies. For instance, companies dealing with, say, the Phoenix Mutual—I named them because they are strictly on a monthly mode basis with their customers, because of the volume of details involved, and each of these premiums is measured on an individual policy basis. Sometimes it takes them a period of weeks or maybe their entire monthly cycle, but on the other hand, you can find situations where all of the accounting initiates with the ceding company and they transmit the premium right from the outset, sometimes before they collect the premium.

[87] Q. On the tremendous volume of business of Provident Mutual that you are referring to, where they may be taking reinsurance on a monthly basis but the ceding company has received the premium on a yearly basis, say, can the ceding company terminate those policies by failing to pay the next month's premium?

A. Sure, and they would if the policy terminated for some reason.

Q. Okay.

A. I might add that the normal arrangement between reinsurer and ceding company on any type of insurance is that the premium isn't paid beyond the point the coverage terminates, whatever that coverage might be, and for whatever reason they may terminate.

Q. The premium is not paid beyond——

A. The termination of coverage.

Q. Now, on the other hand, normally premium is paid at the outset of that particular coverage; it won't be paid for a period in excess of the period of coverage, but it is paid at the outset, or shortly before, shortly after; is that right?

A. Yes, generally speaking, in an accounting period it would be annual or less. Sometimes reinsurance is made for a single premium transfer, but that only occurs, of course, with single premiums. There aren't any advanced premiums, [88] generally speaking, in the reinsurance.

Q. Again my question was to give examples where coverage was in force but premium has not been received. Now you tell me that the normal practice is in this Provident Mutual case, which you suggest is typical, that the monthly payment——

A. It's not Provident Mutual. They are a very large company, but they are not the one I am referring to with this reinsurance arrangement. I am talking about Phoenix Mutual.

Q. I am sorry, Phoenix Mutual. Okay. But that doesn't seem to be an example of the sort that I am asking for. There they pay a monthly premium, they get monthly insurance. They don't pay the next month's premium, they don't get the next month's insurance. Now, there may be a couple days delay in paying the premium, but basically that's the rule, is it not?

A. That's right.

Q. All right. Does the situation ever arise again, to ask my basic question—do other situations arise where a company will assume insurance for a period of years, well before they collect the premium for that insurance? That is, assume an unconditional obligation to provide coverage.

A. I don't believe that would be fundamentally sound, and I don't think it would be permitted.

Q. Could you give me your understanding of the meaning of the term "surplus aid contracts"?

[89] The COMMISSIONER. Surplus what?

Mr. SCHWARZ. Surplus aid.

Mr. SINGER. Could I ask again what the relevance of this is to our case?

Mr. SCHWARZ. Yes, perhaps after Mr. Eddy describes the contract, the relevance will become apparent.

The WITNESS. I could answer now, but——

The COMMISSIONER. All right, we will allow lenience in cross-examination. Go ahead, Mr. Schwarz.

Mr. SCHWARZ. Thank you.

By the COMMISSIONER:

Q. Do you remember the question?

A. Yes, sir, I do remember. There are a variety of such arrangements. Generally speaking, conceptually, what is meant by that, is that through a reinsurance or a co-insurance contract, one company is able to improve the surplus position of the other company. Generally speaking, that flows from the reinsurer to the ceding company. Not always.

By Mr. SCHWARZ:

Q. That is, the ceding company surplus will be improved by the reinsurer?

A. That's the general situation, yes. It could go the other way, through special types of arrangements. Now, the way this comes about, it's been in existence probably as long [90] as the major reinsurers have been in existence. In this country, when you sell insurance, individual policy, annual premium contracts, the competitiveness for salesmen is such that you pay a large commission the first year, we have already discussed, maybe up to a hundred per cent. And because when you make the sale, you've got to go through an underwriting procedure and you've got a certain amount of staff and overhead that is involved with nothing except establishing the policies on your books, you have a net in effect of more outlay than you get in premium income in the first year.

Now, because of the accounting requirements and the statutory provisions or the regulatory authorities, the insurance company is caused to charge off all of its expenditures in the year of issue, and, of course, it only includes in its income this premium.

Smaller companies, and since World War Two there have been a real outgrowth of such companies, are establishing themselves, say, with minimum capital by state requirements, and they find that this drain, if they are successful in

selling, rapidly depletes their capital and surplus—statutory capital and surplus.

So in the competition for reinsurance business, the large reinsurers, Lincoln National, the Phoenix Mutual, North American Reinsurance, Businessmen's Insurance, others that do [91] not come to my mind just this moment—they offer to help these companies along, which they don't refer to it as surplus relief, but in fact type of reinsurance or co-insurance agreements where they in effect substitute for the smaller companies in this first year position. They do that through co-insurance arrangements, becoming—taking the burden of the first year expenses in excess of the first year of premium income.

Now, because life insurance premiums are established so that even though you have this drain the first year, or this burden the first year from a statutory accounting basis, the premiums are established so that as the years go on in renewal, you get sufficient amounts in excess over the years to repay you this deficit with a reasonable return.

Q. Before you go to the reinsurer, let me just interrupt. If a company pays a commission on life insurance, it pays it with the understanding, if it pays it on an annual premium that is received, let's say it pays that commission with the understanding that the policy holder may not continue his insurance the next year, by not paying the premium, is that right? So it's aware of that contingency, right?

A. That's right.

Q. And if the policy holder canceled his policy during the year for which he had paid the premium, the agent is often required to in effect remit a portion of the commission [92] relating to the unexpired term by having his commission the following month reduced by a return commission, in effect?

A. No, that practice is not in existence in the life insurance field. The policy holder does not have the right to cancel during the period for which he has paid the premium. He can cancel by not paying another premium, but there is no provision either to refund the commission to the policy holder or to reclaim it from the agent. So what you suggest doesn't exist.

Q. I see. Okay. Now, can you go to the effect on reinsurance?

A. Well, all right. The reinsurer substitutes in effect for the ceding company in this drain of—this surplus drain position. Of course, the co-insurance agreement really just caused the income from the policy holder to flow right through to the reinsurer, also the disbursements to the agent and other people in effect flow right through to the reinsurer, both first year and renewal.

So that the knowledgeable reinsuring companies, they know that they, in all probability, will get back this drain with a reasonable return on their investment, and that's the type generally, a concept—that's what all surplus type of reinsurance, surplus relief type of reinsurance accomplishes.

Q. But the insurance that is reinsured is between the [93] policy holder and the ceding company, is that right?

A. No, no, the—well, excuse me.

Q. The reinsurance referring to is reinsurance of business written between the ceding company and the policy holder.

A. That's right, but the agreement, of course, the arrangements are not between the reinsurer and policy holder but between the reinsurer and the ceding company. Actually in this type of co-insurance, it appears to have a bad connotation.

Q. Let me just get to this one question and we will get to the connotations. I am not trying to create bad connotations, I am just trying to find what the details are. In this situation the ceding company is primarily liable to the policy holder; is that right?

A. Unless there was an assumption of risk, invariably that is true, yes.

Q. And as a result, the reinsurer is not primarily liable to the policy holder, is that right?

A. That is correct. He deals directly with the ceding company.

Q. The liability with regard to all the parties is the same as it is in this case, isn't it?

A. Quite similar, I believe. Let me think about that one moment. The relationships are the same.

[94] Q. Okay. The ceding company is primarily liable to the policy holder, the reinsurer is liable to the ceding company, under that theory?

A. Yes.

Q. And that's the extent of the liability. Okay. Under the surplus aid contracts, how does the surplus aid concept work? Why is it done, on the part of the ceding company?

A. Well, the ceding company, of course, would do it for their reasons, and now can I expand on this reason—on this connotation thing?

Q. I would rather not.

Mr. SINGER. Are we entitled at this point to know where Mr. Schwarz is going?

Mr. SCHWARZ. Yes, we are pursuing the problem of what unearned premium reserve means in the context where the premium is not received, although the insurance is in force. This is the effect under the treaties in this case.

Mr. SINGER. Where the premiums are not received?

Mr. SCHWARZ. The premiums have not been received, have not all been received for insurance which is in force, and I am pursuing the types of situations in which this has come up in the insurance industry in order to determine how the concept of unearned premium and unearned premium reserves takes this situation into account. We are talking about [95] surplus aid contracts, and under these contracts, as Mr. Eddy will testify, this kind of situation can come up, and I would like to explore just how it comes up and how this compares to the treaties in question.

Mr. SINGER. First of all, are we still talking about life insurance, reinsurance treaties, or——

Mr. SCHWARZ. Well, at the moment we are talking about any kind of surplus aid contract.

Mr. SINGER. How is it relevant to our treaties here? Are you saying that our treaties were surplus aid contracts?

Mr. SCHWARZ. I'm not trying to put a label on them.

Mr. SINGER. Well, then how——

Mr. SCHWARZ. I believe I answered the question. I explained that they are relevant.

Mr. SINGER. I don't see that he has explained, Your Honor. We haven't really—so far in this cross-examination I have yet to hear referred to at all to our treaties, or treaties of the same type. We are talking about life insurance, reinsurance treaties, which have nothing to do with this case, and we are talking about surplus aid treaties which, as far as I am aware, has nothing to do with this case, unless Mr. Schwarz says that our treaties are surplus

aid treaties, whatever they are. I don't see that he has established that this line of questioning is relevant here.

[96] The COMMISSIONER. Maybe we are getting a liberal education from the expert. Go ahead, Mr. Schwarz.

Mr. SCHWARZ. Thank you, Your Honor.

The WITNESS. Is it my turn?

By Mr. SCHWARZ:

Q. Yes. I will repeat my question, if you would like.

A. All right.

Q. Could you explain to us how, in a typical example, the notion of surplus aid can benefit a ceding company. If we take an example where a 100% of premiums are naturally received by the ceding company,—let's say the commissions in the example are 45%, a 2% retainage or commission is earned by the ceding company—or is paid to the reinsurer, excuse me, under the circumstances—so that the ceding company receives the premium, it will remit 55%—I will give you the outline and then you tell me how it works—remits 55% to the reinsurer, which is, of course, less the 45% commission, and the reinsurer assumes the premium.

Now, can you go on from there to explain how such an arrangement would work, where the liability runs and what effect this all has on reserves and surplus, the two companies?

A. Well, in your illustration we have too many things unanswered, unknown, rather, and for instance, if we are talking about life insurance, we would have a different [97] problem than if we are talking about accident and health.

Q. Let's talk about accident and health then.

A. And the surplus relief,—are we still trying to speak with respect to surplus relief, on a reinsurance premium?

Q. Yes.

A. Well, it's almost exactly the opposite of the type of treaties that we have here, but it in effect sets up—if we are talking about accident and health, it causes the reinsurer to establish a statutory liability in excess of the premiums transmitted to it by the ceding company, in the illustration which you have just given.

Q. The reinsurer, is that right? Is that what you are saying?

A. The reinsurer would establish a larger—they would establish a statutory reserve, assuming a hundred per cent

of the risk as being reinsured here—the reinsurer would establish the statutory reserve in accident and health insurance, as it's been said, as the gross premium. So in that case, in that event, the ceding company would have surplus relief, the reinsurer would have a surplus drain.

Q. Now, by surplus relief, could you explain what that means, as far as the ceding company's surplus is concerned and as far as its unearned premium reserve is concerned?

A. Well, I feel that I am repeating myself, but that's [98] all right if you want me to.

Q. That's all right.

A. The ceding company has decreased its assets, whatever they were—fifty-five cents, I believe you said—and it also, though, has decreased its liabilities for that policy, which are presumably in this illustration, was a dollar. Therefore,——

Q. By decreased the liability, you mean decreased unearned premium reserve?

A. Yes.

Q. I see.

A. I am afraid I used liability and unearned premium reserve interchangeably.

Q. That may be crucial here, so perhaps——

A. I will try to stick to the right terminology. The unearned premium reserve then is reduced by the dollar, and the net assets, maybe cash, was reduced by fifty-five cents. That's with respect to the ceding company.

Q. And the surplus increases by what?

A. Well, the difference, actually all this presumably works through an operating statement, so you have in effect a forty-five cent gain, and that is transmitted into an increase of surplus.

Q. Now, is the 55% less the 2% retainage figure, [99] isn't it arrived at in some view as to what the normal local experience would be on those policies?

A. Well, again this all depends on the type of reinsurance you are talking about. If you are talking about—well, the truth of the matter is, all reinsurers—all they collect or get from the ceding company, whatever it takes to pay the claims, so it is related to the insured risk.

Q. Okay. Now, if it turns out under these typical surplus aid contracts that the loss experience is adverse, that is, it

is worse than was contemplated by the party when it determined the portion of the premium which would go over to the reinsurer, isn't the insurer obligated to pay an additional amount to the reinsurer?

A. Not always. The practice varies——

Q. In some contracts isn't that the case?

A. In some contracts, that's true, yes.

Q. And isn't it true that if the loss experience is favorable in some of these contracts, the reinsurer will remit back to the ceding company a portion of that 55% it received?

A. Well, the surplus relief type of contracts that you are talking about, that's not the way it really w rks in practice.

Q. Isn't [100] that the effect, regardless of practice, isn't that the effect of what happens?

A. When the reinsurer substitutes for the issuing company, say in life insurance—and I am speaking of life insurance—but the same principles are involved, I believe, in all—once the reinsurer has recovered what it had to take out of its surplus at the outset, by making the substitution, with whatever rate of return it is satisfied with, through the terms of the agreement and through the mechanics of the agreement, then quite generally there is an automatic recapture by the ceding company.

So that after the one time when the reinsurer—he has provided surplus relief at the outset, he has waited until he's gotten—he's recovered, then the contract is terminated and the ceding company goes on its way and the reinsurer its way.

Q. The risk in this coverage remains with the ceding company, doesn't it?

A. The individual—well, to the extent that the premium income is adequate to meet the claims and fulfill the other terms of the agreement.

Q. That's the way it is in all insurance, isn't it?

A. Well,——

Q. You asume the risk whether the premium you have is adequate or not. The whole idea is if it is not adequate, [101] that's your risk.

A. Well, in the typical case of surplus relief reinsurance, typical case, you do not—the ceding company is really just a channel through which the premiums come in and the

claims go out and, of course, that offers administrative services during this period of time.

Q. And primary liability, does it not?

A. Well, not necessarily. What happens, unless the entire block of business goes bad, and quite generally the reinsurer is stuck with the loss, what happens in most typical surplus and relief contracts is that it is in effect sort of an open end arrangement, that this recapture doesn't occur until the policies continued in force have in fact made the reinsurer—reimbursed the reinsurer for its investment and cost, and an adequate return.

Q. Even though the insurer is assuming a risk on this insurance, it is still permitted to take credit for its own unearned premium reserve under the rules of some states, is it not?

A. If unearned premium reserved—the reinsurer would establish the unearned premium reserve in the illustration that you gave, because it received the premium, and the ceding company would take credit for it because it had received actually the transactions, would be in the ceding company's [102] statement—they would establish the unearned premium reserve because they had received the premium, but then because they had passed it on to the reinsurer, they would take an offset or credit and this would then net to zero on their balance sheet.

Q. And the effect is that they don't have, because of the credit, they don't have to show this unearned premium reserve liability. The only way—the effect of that is to increase surplus. Surplus couldn't be increased without the credit of the unearned premium reserve, isn't that right? It couldn't balance, could it?

A. No, of course, in the illustration we are talking about.——

Q. Did you say no?

A. Well, in the illustration we are talking about, I may have misstated the effect on the ceding company's balance sheet to this extent. You gave the illustration of a dollar premium and forty-five cents commission and fifty-five cents reinsurance premium. Without reinsurance, the ceding company would have had a net income of fifty-five cents, but would have established a liability of a dollar. If nothing else

happened, it would show a loss that year of forty-five cents. If nothing else happened, it would show a negative surplus of forty-five cents.

[103] Now, if it immediately reinsured with a surplus relief, or any other type of reinsurance, the whole risk at that point, by transferring to the reinsurer the remaining fifty-five cents which it had, and the full risk, the reinsurer then would be substituting for the ceding company. It would show on its books income of fifty-five cents, reserves of a dollar, and, therefore, a loss of forty-five cents, but the ceding company would be in a zero position.

Now, compared to not reinsuring, it would be forty-five cents better, but if we were just passing the money right through to the reinsurer, the ceding company would neither have a gain nor a loss as a result of the transaction.

Q. Now, in the example I just gave you, and I believe you agreed that there are ceding companies—there are situations like this where, if the loss ratio, that is, would be the 52%, which is the 55% less the 3% commission, if that 52% loss ratio was exceeded, that is, losses were greater than expected, the ceding company would be required to remit the losses in excess to the reinsurer and the arrangement were favorable, the reinsurer would remit the deficiency back to the ceding company. You have seen agreements like that. Are you familiar with that kind of arrangement?

A. Well, the explanations I keep trying to give, of my understanding of reinsurance and surplus relief reinsurance, [104] really isn't dealing with the questions that you are asking because you are asking things which to me strike or suggest that you are talking about single premium credit, A and H.

Q. I am not.

A. I am not talking in terms of that type of contract. I think that the type of contract we have here is pretty typical.

Q. Mr. Eddy, I am asking you about a typical A and H policy and a typical surplus aid contract as it might arise in an A and H policy. I am not talking about the contracts here, I am trying to get at a principle, and I would like to confine myself. Now, the example I am giving you is out of the same handbook, and opposing counsel can look at it

again if he likes, and I am told by this report, such a situation exists. I only am asking you whether in your experience you have run across this same situation.

Mr. SCHWARZ. Would you like to see this?

Mr. SINGER. Yes.

[Document referred to Mr. Singer.]

The COMMISSIONER. Off the record.

[Off-the-record discussion.]

The COMMISSIONER. All right, we will return at 2:00 o'clock.

Mr. SINGER. I wonder, if you would like to look at [105] this, or could he look at this before we resume cross-examination? Would that be helpful to you, Mr. Eddy?

The WITNESS. I think so.

Mr. SINGER. It appears that Mr. Schwarz is relying pretty heavily on this handbook and Mr. Eddy has not had a chance, at least recently—I don't know if he ever had a chance to read it—it might be helpful if he can read it over.

The COMMISSIONER. I am sure Mr. Schwarz wouldn't have any objection to his seeing it.

[Whereupon, at 12:45 p.m., the hearing was recessed, to reconvene at 2:00 p.m. the same day.]

[106] AFTERNOON SESSION

[2:00 p.m.]

The COMMISSIONER. You will resume the witness stand, Mr. Eddy. Proceed, Mr. Schwarz. Whereupon,

ARTHUR CROOKS EDDY resumed the stand and, having been previously duly sworn, was examined and testified further as follows:

CROSS-EXAMINATION (Continued)

By Mr. SCHWARZ:

Q. Mr. Eddy, before we return to the subject we were discussing before lunch, I would like to emphasize that some of the examples that I am giving to you are not exactly the same as the kind of treaty that we are involved with here. I am asking for purposes of comparison and in order to discuss the principle of an unearned premium reserve and the term "unearned premium," so you will have an opportunity to relate these examples to the treaty, either based on

questions that I ask you or based on questions in re-direct. So I would appreciate it if your answers are pointed and in direct response to my questions, and we will be concerned with the analogies later.

A. All right.

Q. Now, to return to the example we were discussing, have you had an opportunity to read the example that I referred [107] to?

A. The first paragraph, but I didn't get into the second one.

Q. Okay. Well, I can either go over it again or give you an opportunity to read it, whichever you would prefer.

Mr. SINGER. Whichever is easier for Mr. Eddy.

A. It's a little late. If you would just go ahead and ask the questions, I think I could answer you.

By Mr. SCHWARZ.

Q. The example,—I will briefly restate the example for the record. It involves a reinsurance treaty and the example does not state the type of insurance. It covers various types, but we can assume that accident and health insurance, and maybe even credit accident and health, I don't know, could be reinsured on this basis.

A. Would you be kind enough to read the italicized heading of the paragraph? I think that makes it quite clear.

Q. It's headed—the major heading is "Normal effect produced on unearned premium reserve and surplus of a ceding company by the session of reinsurance." It then discusses the normal effect which we discussed before, and then they go, under the next heading, to surplus aid contracts and then they define a surplus aid contract, and then they start with another heading called "Guaranteed profit contracts," and [108] the first sentence essentially says the most common form of surplus aid is the guaranteed profit contract.

So the one we are discussing in the example which we are going to pursue is an example of a guaranteed profit contract, which in turn is, as they say, I assume, a common form of surplus aid contract. Are you familiar with the term "Guaranteed profit contract"?

A. Well, to that extent, yes.

Q. Okay. And are the commissioners correct in saying that it is the most common form of surplus aid contract?

A. Well, I don't think I share that opinion.

Mr. SINGER. Excuse me, Your Honor. Is it clear that this is the commissioners saying this, or is this a report prepared for the commissioners?

Mr. SCHWARZ. Well, this section of the handbook is entitled, "Examiner's handbook, National Association of Insurance Commissioners." Now, we are in Part B, and Part B is entitled, "Reinsurance subcommittee reports as amended." Now, for the reference, they refer to the 1961 NAIC proceedings, Volume 1, pages 147 to 177, and that report is set forth here.

Mr. SINGER. Isn't there some introductory paragraph? This is a subcommittee of some committee of the National Association of Insurance Commissioners?

[109] Mr. SCHWARZ. It may be a subcommittee on reinsurance. I'm not introducing this into evidence.

Mr. SINGER. But you are speaking here as though the—what is contained in this handbook is something that the commissioners have said or promulgated. I don't think that that's correct.

Mr. SCHWARZ. Well,——

Mr. SINGER. A correct way of stating it.

Mr. SCHWARZ. All right. Let me be more specific. The subcommittee is called the subcommittee to study the question of reinsurance, and that is the name of the committee, and the introductory paragraph speaks of a meeting in 1950 of members of that committee, and this is the product of that committee—those committee meetings. This is a report.

Mr. SINGER. This is a report by the subcommittee based on meetings held in 1950.

Mr. SCHWARZ. That's right.

Mr. SINGER. And is there anything in there that shows that the commissioners have ever adopted these conclusions as their own?

Mr. SCHWARZ. Well,——

Mr. SINGER. Or are these just recommendations?

Mr. SCHWARZ. I don't know if any more can be said about that question, except that they have inserted that into [110] a handbook which they issued to examiners. Perhaps you could tell us what this handbook represents and what it is used for.

A. Well, it's somewhat of a guideline for examiners in performing their examination. In fact, that section, the parts that I read, dealt specifically with the treatment of reserves between reinsurance ceding company, and I think that's what it's for.

By Mr. SCHWARZ:

Q. Now, who are these examiners you are referring to?

A. Well, the several states have their own insurance departments which employ people classified as examiners, and these gentlemen, ladies and gentlemen, are supposedly familiar with the life insurance and general insurance, as well as life insurance, business, and they are required by their various states to examine the companies domiciled in the state in this triennial examination to ascertain whether their assets and liabilities are appropriate according to the state regulations and statutes.

Q. Who are these insurance commissioners who are members of the National Association of Insurance Commissioners?

A. Well, I don't know for sure that all commissioners are members of the association, but I suppose that they are. I believe that's true. The commissioners are in some cases appointed officers of the states. In some cases they are [111] elected officials of the state, and they have amongst their responsibilities and duties the supervision of the insurance affairs of the state.

Q. Do they also supervise the examiners who perform these audits you referred to?

A. The organizational structure varies between the states, but generally speaking, I am sure that the commissioners are considered to be their superiors.

Q. You said before, in response to direct examination, that an insurance company, say like a taxpayer who is domiciled in Missouri, would be subject to an examination by examiners not only from Missouri, but perhaps by other states.

A. If it were licensed in other states.

Q. I see. But it would be examined by examiners from all states in which they were licensed?

A. Well, not generally. The practice varies with this, too, and also it varies with the size and importance of the company to a given state where the company might be licensed.

But generally speaking, the states are divided into zones and the zone that the company is domiciled in encompassing more than one state, several states generally, will usually provide one or more examiners. Or excuse me—each state within its own normally would provide one or more examiners [112] to aid in the examination, and the chief examiner in an examination is most generally from the state that it is domiciled in.

Q. Now, what effect does this handbook have on these examiners in their work? First you said before that it was a guide to them?

A. Right.

Q. Their essential guide is the law of the state, is it not?

A. That's right, and regulations, and to the extent that this thing is not in conflict with the state laws or regulations that are involved in the particular examination, then this is the guideline and an attempt, as I mentioned earlier, for a uniform regulation of an insurance company.

Q. An example of a deviation between what may be suggested in the report and what the law is would arise, would it not, in a situation we discussed before, involving every insurer that is not licensed to do business? Are you familiar with the recommendation of the examiners, of the insurance commissioners, that the fact that a company is not licensed should not be taken into account; if it is a solvent company, the credit should be given regardless of the technicality of the licensing, but in fact some states still have licensing requirements?

[113] A. Oh, yes. In fact, the states vary considerably in their practice in that, and generally speaking, it's pretty much discretionary, I believe, for the state authorities, regulatory authorities, whether it be examiners or commissioners or whatever, to allow or disallow reinsurance credit for reserves, depending on their understanding of the solvency or the ability of the reinsurer. Some states—particularly New York, as an example—that's not quite true. You have to be licensed as a reinsurer in the state of New York, like in other states.

Q. You say they have some discretion as to whether to allow credit or not to allow under these circumstances?

A. That's my understanding, yes.

Q. Doesn't the state law originally and technically and specifically specify the exact circumstances under which the credit should be given or not?

A. Well, I don't believe so. Well, excuse me. I believe that the general evaluation laws do refer to reinsurance credit. In some cases, some states, I think, that you will find, though, that the reinsurance credit—first of all, generally speaking, you are permitted the reinsurance credit, but then I believe some state laws go beyond that and specify that they must be licensed.

Q. Are the individual commissioners within a state [114] given discretion on other questions involving the nature of reserves within the purview of the statute?

A. Well, as I said earlier, all states, I believe, have adopted the standard valuation law, which presents in concept or presents the philosophy of reserve valuation specifically with respect to many kinds of insurance. In other types it is very nebulous, but the law does—at least the standard provision does state that the calculation of other reserves should be consistent with the principles involved and the specifics that are given or enumerated.

There are other laws or other regulations that are involved, and if you ask me if commissioners have discretionary powers, it has been my experience in many areas where there is a lack of uniformity, sometimes with the regulations and sometimes the statutes are different with respect to the supervision of insurance companies.

Q. If the commissioners had required to reinsure the taxpayer in this case to create and show on its books an unearned premium reserve for the amount of premium it would receive under the treaty, would that be a violation of the state law as far as you know, as opposed to—in other words, would they have the power to do that if they felt that a reserve would be necessary, either to protect the ceding company or to protect policy holders, or for whatever reason? [115] A. Well, in my opinion, in the case involved here, I don't believe that they would have the power to impose that requirement on the ITT Hamilton.

Q. And the reason for that is because you understand the meaning of the reserve to be the amount of premium received, which has been unearned?

A. Well, there is no question in my mind that the unearned premium reserve, as determined in the life insurance industry, relates to the premium received and it is proportionate to the period of coverage. It doesn't have to do with dollars and cents, dollars received; it has to do with the portion of the period the premium covers, and sometimes it is related to gross permiums, it is sometimes related to the cost of carrying the insurance risk, sometimes it is statutory and sometimes in very rare cases you might find it related to the real cost of carrying insurance which would be less if you got to the mortality or morbidity tables.

Q. Now, the question which I started my cross-examination with and the one, as far as I am concerned, we are still pursuing, are situations in which a company has insurance in force but does not have the premium, does not hold, to use the plaintiff's term, the premium on that insurance, and in connection with that, we were discussing surplus aid contracts and specifically the guaranteed profit contract, which we left [116] off with a lunchtime. And let me review that example again briefly, and my question to you, with regard to that example, would be, first of all, whether you are familiar with it, and then to discuss it.

The example is one where the insurer, the ceding company, received a premium which we will describe in percentages as being 100%. It remits 55% of that premium to a reinsurer, 3% of which represents a payment to the reinsurer for its services in connection with this agreement, 45% of the total consists of a commission, which it, the ceding company, pays immediately to its agents, and under the treaty if the loss experience on this particular coverage is unfavorable, that is, the losses which the company has to pay exceed this 52%—now, of course, we are talking about an aggregate of all policies, not on any one policy—the ceding company would be required to remit the excess to the reinsurer because the reinsurer has been paying these claims all along, and if a loss experience is favorable, that is, it does not reach the 52% level, then the reinsurer will remit back to the ceding company a portion of the premium it has received. So the effect of the whole arrangements——

A. An experience credit of some sort.

Q. Yes. The effect of the whole arrangement is that the reinsurer makes 3% of the premium. That 3% is made without [117] any risk, it's guaranteed. That's all it makes, no matter what happens under the policy. If the claims experience is extraordinarily adverse, the ceding company suffers. If the experience is extraordinarily good, it benefits.

Now, are the commissioners correct in describing this as the most common form of—or is the report correct in describing this kind of contract as the most common form of guaranteed profit contract, or was it correct at the time?

A. It may be the most—as a matter of fact, of course, if we are referring to 1950, and if you say that this was something that was from the proceedings of 1950, I think that things may have changed since that time. I think perhaps maybe even during the period of this particular case, they may have changed. I think that that's a common form of contract in certain forms of insurance. I don't think by any means it is the most common form of surplus relief, reinsurance or co-insurance in the life insurance industry.

Q. Now, a surplus relief contract again is not the most common form of reinsurance, is it?

A. That is correct, it is not. It's quite common, but it is not the most common. The most common form is the regular risk premium reinsurance or yearly renewable term insurance, as it is sometimes called, or as we are talking about today, it is the ceded type of insurance. I think that [118] was the terminology. The terminology is the most difficult communication problem, but at any rate, I think that that is the common form of co-insurance. Now, I did see that illustration that you were talking about and I do want to point out—you said at no risk. Even the commissioners admit that there might be some remote risk here because if the claims aren't—they could exceed 100% of the premiums.

Q. How do they describe that risk? Do you recall?

A. Well, I said remote. I'm not sure that's the word they used.

Q. Largely of academic interest?

A. That's how they described their interest in it, but I think they refer to it as remote.

Q. I will read the sentence. "This is a remote possibility, largely of academic interest." All right. Now, let's review again the effect of this treaty on the surplus and reserves of the ceding company.

A. This is hypothetical? Well, this thing that you are referring to in the book?

Q. Yes.

A. Well, as I mentioned earlier, if this is the accident and health type contract where the reserve, the statutory—if the statutory requirement is the gross unearned premium, then the effect on the ceding company would have been [119] before reinsurance, one dollar premium, 45% expense for commission and after reserve requirement of a dollar, net loss of forty-five cents. After reinsurance, they would have a net zero premium income, net zero reserve requirement, forty-five cents—excuse me, I am not saying that properly.

They would have zero reserve, which is correct, and they would have—they would take their forty-five cents, or fifty-five cents of assets, and pay it to the reinsurer, and they would have then in effect no gain or loss on this transaction because they transferred a hundred per cent of their premium, namely, forty-five cents to the agent and fifty-five cents to the reinsurer, and a hundred per cent of their liability, so they got no gain or loss after the transaction.

Q. What's the effect on the surplus?

A. Well, related to their surplus before the transaction commenced, it is no effect.

Q. Right.

A. But related to their surplus if they had reinsurance or not, but the transaction did exist, then they have increased their surplus by forty-five cents.

Q. At the moment it receives the premium, if at that time a statement were made, the effect would have been that they would have to create a reserve of one for one, as you say?

A. Yes.

[120] Q. It would have an expense against that of——

A. Forty-five cents.

Q. Forty-five?

A. Yes.

Q. And those—most of those items would be going against surplus, wouldn't they, whereas it would be only one forty-five against surplus, but only one of income. Wouldn't that be a loss? Wouldn't that loss reduce their surplus?

A. That's true.

Q. So the effect of it is that when the reinsurance takes place, if you can say, the effect is to increase surplus over the situation that I just described?

A. Correct. Before the transaction—excuse me. Without reinsurance, and we do have a transaction of the insurance sale, there is a surplus drain of forty-five cents or a loss, which reduces the surplus forty-five cents. If the transaction continues through a reinsurance arrangement, then the effect on the company is zero, or compared to no reinsurance, it's a 45% improvement of surplus, or forty-five cent gain.

Q. So it is a restoration?

A. Yes, it really puts them back in a position as if they hadn't made the transaction.

Q. Now, an effect of this whole thing on the reinsurer, and we did cover this somewhat before, but now that we have the [121] example straight, I appreciate your opinion. What is the effect on the reinsurer?

A. If again we are speaking of A and H insurance, so that we can say that the statutory reserves related to the gross and not to the net——

Q. Okay, let's assume that.

A. All right. We have to make that an assumption, otherwise my illustration would be incorrect.

Q. All right.

A. In this event, the reinsurer would receive fifty-five cents and it would establish a reserve of a dollar, thus showing a loss of forty-five cents or a reduction in its surplus of forty-five cents.

Q. Okay.

A. I don't know if it is appropriate or not, but I would like to point out one thing, and I think that the commissioners refer to this, too. The theoretical surplus or imaginary surplus—in the first place, the requirement for statutory reserves of a dollar is somewhat unrealistic.

Q. We will get to the significance of the gross versus the net. I believe that is what you are alluding to.

A. No, not really. I just wanted to mention one thing. The accounting profession of——

Q. I will have to ask you to—if you are—if on [122] redirect they want to go into that, they will have to do it. It's not really appropriate here.

A. Okay.

Q. Now, except for this remote possibility of losses exceeding total premium that you referred to when we discussed it before, who has the risk of loss?

A. Barring that risk, then you have to assume that the ceding company has the risk.

Q. The ceding company?

A. Yes.

Q. Not only assume it, it does have the risk, doesn't it?

A. Barring that possibility, yes.

Q. Okay. Now, under those circumstances, some states, and I don't know how many, perhaps I could ask you, would allow—did allow a credit to the insurer, to the ceding company, for the unearned premium reserve on those policies?

A. Correct.

Q. And it allowed the reinsurer to establish that reserve?

A. Correct.

Q. Now, before you said several things about the nature of the reserve. First of all, you said that the reserve was designed to provide a fund from which a refund could be made [123] to a policy holder in the event that the policy was canceled.

A. I said that was the rationale for establishing gross unearned premiums.

Q. Okay.

A. I don't admit to the reasonableness of the requirement.

Q. Okay, just the rationale, pardon me. Now, the reinsurer has the premium here, doesn't he? The forty-five cents has gone to the commissioner—the agent——

Mr. SCHWARZ. Pardon me, Commissioner.

By Mr. SCHWARZ:

Q. And the remainder has gone to the reinsurer; is that right?

A. Yes.

Q. All right. Now, if the policy holder asks for a refund, there is only one place he can turn for the refund, isn't there, under his policy?

A. To the ceding company.

Q. Okay. Now, where are they going to get the money?

A. They have to turn to the reinsuring company.

Q. Okay. And if they don't, if the reinsuring company has become insolvent in the meantime, what do they have to do?

A. Well, I presume they have to take it out of their own accounts.

[124] Q. Their own accounts?

A. Yes.

Q. Okay. Now, the commissioners have said about this kind of arrangement, I am quoting from the report, and if you would like to look at it, you can, but I believe there is an accurate quote—it says, "It appears that some uniform law against credit for transactions of this type is necessary unless the general plan for the regulation of insurers is to become meaningless to a great extent."

Now, first could you, before I ask whether you agree—I am curious to know what your understanding of their concern is, what do they mean by the general plan for the regulation of reinsurers and why might that become meaningless to a great extent?

A. Now, I can say what I wanted to say earlier. This all evolved, I think, because as I started to say, shortly after the Second World War there was a great outgrowth in small new insurance companies, and if they were successful in selling business,—take the accident and health—this is a pretty good example, where if they have to pay forty-five cents out in commissions, and even though the fifty-five cents left over is completely adequate to pay claims, they were forced to establish a dollar reserve, it doesn't take many such sales for a small company, related to the size of the [125] company, before it is statutorily insolvent, and this is because of the requirement of the gross unearned premium reserve, a statutory reserve.

Therefore, many of these companies came into existence and found ways to continue in existence through surplus relief reinsurance, and amongst them being the type—certain types of policies, particularly short term casualty type

policies, the type that you are talking about here as guaranteed profit reinsurance arrangements.

Now, the commissioners—another aspect of this thing—many of these companies had poor reputations because some of their policies were specialty policies. Many of the sales were made supposedly, reportedly, by misleading the customers, and the insurance industry and the commissioners were concerned about the continuing existence of them, which they could control if they were requiring a certain statutory solvency, which they couldn't control as long as they remained statutorily solvent through this surplus relief.

I believe, myself, that that is the source of this type of concern and the cause for it, and, although, I don't believe today that there is any way that they can deny this credit. In fact, I believe that in this stuff that you have just read, they say in effect that there is nothing they can do about it.

[126] Q. Do you think that the general plan for the regulation of insurers, that they refer to, contemplated—took into account this kind of an arrangement? This kind of arrangement evolved when, did you say? After World War Two?

A. Well, the surplus relief co-insurance has been in existence probably most of the century, but I can't say for sure when it came into effect, but I know for a fact that these small new companies were mostly created since World War Two. That's when we had the great increase in the number of companies.

Q. Now, the suggestion they seem to be making,—tell me if I understand this—is that a bar against credit should be required in transactions of this sort.

A. Sure, if they could disallow credit, these companies would become insolvent statutorily.

Q. Have any states taken that advice?

A. I don't know. My own opinion is they couldn't.

Q. They could not?

A. They could not. That's my opinion, but I don't see how they can do that. I don't know for a fact whether any state has or has not.

Q. Do you know if any states previous to this suggestion had prohibited such a practice?

A. Again I say I don't think that they can.

[127] Q. I am asking you, do you know whether they have?

A. No, I don't know of any examples where they have.

Q. Okay.

A. I know of a number of cases where there has been pressure to do it, but they never have succeeded in the cases I have been involved with.

Q. But in a case where the states have in fact prohibited it, if such a case exists, and you said you don't know, is that right?

A. Yes.

Q. Or in a case where under the existing law the commissioner exercised discretionary authority and prohibited that, the effect would be to have two unearned premium reserves, wouldn't it—one on the part of the insured and one on the part of the reinsurer?

A. If we could have the hypothetical situation where the ceding company was barred to credit but the accepting company had the money, then yes, you could have.

Q. I would like to read you another quote from this handbook and ask whether you agree with it or disagree. "Although it is a fully recognized fact that the procedure in the United States with respect to setting up an unearned premium reserve equal to 100% of such unearned premiums without credit for acquisition costs, sometimes results in [128] the establishment of hidden reserves in the guise of unearned premium reserves"—the trouble with some of this is the sentences aren't appropriate—that's not a sentence, but there is a period.

A. I follow that perfectly.

Q. So I will continue. "There are arguments in favor of this practice. The heavy charge to surplus for such acquisition costs sometimes prevents the ambitious or over-rapid expansion of a company that might well result in its ultimate insolvency. It further imposes in an indirect manner additional capital requirements on companies having large amounts of business in force." Do you agree that it does serve that function?

A. I do agree that that's a result of it.

Q. And the uniform practice in all states on accident and health and credit accident and health insurance is the gross unearned premium?

A. Yes, for the direct insurer.

Q. And for the reinsurer, too?

A. Well, it depends on what we are talking about.

Q. Let's take an example.

A. Today I'd say yes.

Q. What?

A. Today that answer is correct, yes. There is no [129] question about it. As a matter of fact, subsequent to the publishment of that book, the NAIC changed its convention blank and instructions to tell a company how to complete the convention blank. By convention blank I am referring to the annual statement. They include specifically a question relating to reinsurance of accident and health insurance, and the companies are obligated to answer that they do or do not show—the reinsuring companies are obligated to answer yes or no that they have included the gross premium charged by the ceding company as their unearned or not.

Now, just to answer that question doesn't mean that some companies don't continue to do it or some states don't continue to permit it, but it is, and very much, I suspect, as a result of this, these recommendations now, one of the questions that are in the convention blank. I didn't think of that this morning or I would have mentioned it at that time, but I did know that during this period of time that we were talking about, that the practice was for the reinsurer to set up a net reserve rather than a gross reserve, and it was right about that time or the end of this period that some of the states began to require that the reinsurer establish gross reserves and not net reserves.

Q. And they did that after the commissioners changed the blank and reported their——

[130] A. Well, no, I think some states probably impose this as a requirement through regulation, before the commissioners actually changed the convention blank.

Q. I see. So the authority existed under state law and they promulgated the regulation or changed the practice of the administrative proceeding?

A. In some states, and not in some. I just happen to have had experience with one or more states on this.

Q. I see. Now, I am curious to know why, before this practice was challenged, why the commissioners in the insuring state would permit the company to take a credit for reserves even though the insurer was still primarily liable on the policy when the purpose of the reserve, as you stated

before, one of the major purposes at least is to provide a fund for the payment of premiums over the remaining term, which the company is bound under the policies. Is there any rationale?

A. Excuse me—payment of claims.

Q. I am sorry.

A. You said premiums. Excuse me, what was the question?

Q. I am curious to know why some of the commissioners in these states would have permitted insurers to take a credit for reserves under these circumstances where they retain the risk. Might one of the reasons be that it wasn't like the insured was out in the cold, there was a reinsurer and the [131] reinsurer had a reserve, and even though the policy holder couldn't go against the reinsurer, the insurer company, and so there was a reserve—there was one reserve at least held by an insurance company with respect to this obligation. Might that have influenced their decision to allow the credit before it came into criticism?

A. Well, I think they allowed a credit before and after any criticism, but the point is that the reserve, however it's defined in the statute, is related to the premiums that have been paid. This is on a retrospective basis, as I have said—you've got to have remaining or left over enough to cover the unexpired period of coverage. Now, it doesn't relate to the gross premium as charged to the customer except in the case of accident or sickness, and that just happens to be the way that the regulations require, or the statute requirement for reserve. It might relate to a net cost of carrying the risk premium and not the gross premium.

Q. The gross premium isn't just limited to accident and health insurance, is it?

A. Well, most fire and casualty coverages,—most casualty coverages, the gross premium is the basis for statutory reserves.

Q. For tax purposes, too?

A. Well, yes.

[132] Q. Is that true for A and H as well?

A. Yes.

Q. And credit A and H?

A. Yes. I am not recommending that you change it, but that's the case.

Q. The companies prefer it on a gross basis?

A. I can't answer that. I would suspect yes.

Q. Why do they prefer it on a gross basis?

A. Well, the answer has got to be obvious. From a tax deduction point of view, it's a larger deduction.

Q. From your understanding, do you know what the deduction was of the insurers under our treaties? Was it gross or net?

A. Well, I don't know for a fact. I just know it from my understanding of the terms of the agreement and what I think that they actually did in practice. They were taking gross—as a matter of fact, I can say for sure about Pilot because I was there—we were taking the reserve, we had it set up for statutory purposes, which was the gross.

Q. Okay. Now, we have through all this time—we have covered two examples of the kind of situation which I asked about when I opened my cross-examination. To refresh me and everyone, I will repeat it. I was asking for examples in your experience of situations where a company had not received a [133] premium, did not have the premium, but had insurance in force with regard to that premium, and you gave me—the first example was the situation where policies providing for annual premiums, remitted to the ceding company, would be reinsured on a monthly premium basis. That was your first example. The second example was one that I introduced and discussed at some length, the surplus aid contract and the guaranteed profit type of surplus aid contract. Can you think of any other examples?

A. Mr. Schwarz, I didn't mean to say, if that's what you just said I said, that I think that insurance exists in force as a general rule and as a practical matter without the receipt of premiums. I did mention that there is a timing question and there is a period of time, maybe the grace period, namely the grace period, in an ordinary policy, and also a timing question with respect to new insurance of almost any kind where the premium maybe hasn't been paid and the insurance company is treating the insurance in force, but if it came to a claim payment, one wouldn't be made, excepting under certain exceptions.

Q. I believe, and I apologize for not including that in my review, in connection with the first example. You did say that under some policies, although the premium was required to be paid at the beginning of coverage, under the policy,

[134] the practice was that sometimes there was a delay and sometimes the policy provided for a short grace period within which the policy would be paid.

A. The grace period is in the renewal area, it's not at the outset. But at the outset you have the practical problem of getting the premium precisely at the moment that the coverage is approved and put into effect, but I don't believe there are any cases where the insurance would be honored as being in force if the claim should be incurred before the receipt of premium. But there are exceptions to that, which I can think of, but it's not the general thing.

Q. All right. Well now, again, you have covered two examples and I am asking for others, any others that you have had in your experience, which conform, and I would like to discuss those with you, if you can name them.

A. You asked me for examples in my experience where insurance was in force without the premium received? Well, I don't intend to have given you any of them, so far. I just don't think that in the payment of claims you wouldn't make claim payments on premiums when you haven't received premiums.

Q. You can have insurance in force without paying a claim, can't you? I have a homeowner's policy and I haven't had a claim yet, but the insurance is in force yet.

A. You paid the premium, haven't you?

[135] Q. Sure have.

A. Okay.

Q. So can you give me examples of the sort that I asked? It seems to me the first two you have given are examples, and we have discussed those examples.

A. Well, no, I still disagree that that's an example of your question.

Q. Well, don't argue with my characterization. I just want factual situations which conform to that mode. Now, I asked you the first example involved a life insurance agreement and you told me, well, the policy requires the premium to be paid at the outset but sometimes it isn't. Okay, we will accept that. And under the reinsurance of those policies providing for annual payments, a reinsurer may pay on a monthly basis, and that monthly reinsurance premium may come a little late or may come within a grace period.

A. Again, a timing period.

Q. All right, we will accept that.

A. But in a settlement, any final settlement, the benfit will also relate to the period for which the premium had been received.

Q. I understand that.

A. Okay.

Q. Now, in both of those examples, policies required [136] by their terms the premium to be paid at the outset?

A. Yes.

Q. All right. Now give me some examples where they don't, where the policy, or the treaty or whatever, where it doesn't require it to be paid at the outset but coverage is in force for the period for which the premium is eventually going to be paid.

A. Well, if the question is an example of a case where insurance might commence before the premium is due, whether it is paid or not,——

Q. Excuse me, you will have to repeat that. I didn't follow you.

A. I say, if you are asking for an example where insurance might commence, the effect would be to make the insurance company liable for a claim prior to the date that a premium is due, I don't believe there are any. If you are saying before the actual receipt of the money, I think there are the cases that I have said and they are purely timing problems.

Q. Well now, under the reinsurance treaties involved in this case, the insurer, reinsured,—and I am referring now to the Pilot and National Fidelity treaties, and you can assume I am referring to those unless I refer to the Old Republic treaty—the Pilot and National Fidelity treaties [137] were identical in their provisions, were they not?

A. Fairly nearly identical, yes, if not identical.

Q. Under those treaties the insurer was required to, and the reinsurer was required to accept, to reinsure 100% of the liability which the insurers had accepted with respect to credit accident and health policies issued to the debtors of Aetna Finance Company; is that right?

A. Yes.

Q. So when a debtor of Aetna Finance took out a loan, and I understand the average loan for which this kind of coverage was provided was a two year loan, and let's assume

two year policies throughout, the provisions were that the insurer would reinsure 100% of its liability with the reinsurer,—is that your understanding?

A. Yes.

Q. The reinsurer's liability commenced the moment the insurer's liability commenced and would not terminate until the insurer's liability terminated; is that your understanding?

A. That is my understanding.

Q. So at no time was one liable without the other one being liable?

A. Right.

Q. In these cases the primary liability was with the insurer?

[138] A. You mean the liability to the policy holder?

Q. Yes.

A. Yes.

Q. And the insurer would then have the right to turn to the reinsurer for any claims it had to pay out?

A. The ceding company would, yes.

Q. The ceding company, I'm sorry.

A. Yes.

Q. Okay. Now, is it your understanding that when such a treaty—when such policies were accepted by the ceding company under this automatic reinsurance treaty, that the reinsurer accepted liability to provide coverage for the full term, two years in our example?

A. Sure.

Q. Is there anything in the treaty that suggests otherwise?

A. Not as long as the ceding company made their premium payments.

Q. Does it say that in the policy?

A. Well, I'm not sure. I'm not sure it says that, but——

Q. You have examined these?

A. Yes, I have examined them.

Q. Would you like an opportunity to look at them again?

[139] A. Well, I'm not sure it will help. Can I ask you a question?

Q. No, I asked you whether there is any provision in these policies which said that the liability of the reinsured terminated if it did not receive a monthly premium?

A. The termination provision relates to the termination of the coverage of insurance.

Q. What does that say?

A. Well, I couldn't quote you verbatim, but the liability of the reinsuring company is coterminous with that of the ceding company.

Q. And what do you take that coterminous to be?

A. It ends at the same time.

Q. It begins at the same time?

A. In other words, you mean it begins at the same time, but I think it runs for the same period.

Q. That seems to be contrary to your suggestion that the insurance would terminate if the premium wasn't paid.

A. Well, I don't know that it does, and I really can't answer that. I think that the reinsurer would not pay any claims if it hadn't received the premiums. As a matter of fact, one of the provisions of the treaties call for claims to be deducted from the premium payments.

Q. But you don't see any term in the treaty which would [140] suggest that, do you?

A. Suggest what I just said? There is a term in the treaty that says that claims will be deducted from——

Q. Yes, not that. There is no term in the treaty which says if the insurer fails to remit the monthly reinsurance premium as provided under the policy, the policy will terminate and the reinsurer will be no longer liable for any coverage provided under the policy. Does it say anything like that?

A. I don't believe so, but I believe I would have to read the contract through to be sure, but I don't think it does.

Q. Is there a grace period in these treaties whereby the insurer has a delayed period within which it might pay?

A. Not in these treaties, although I'm not sure about the premium payment clause. As a matter of fact, there is a premium payment clause in it that they were to remit by the 25th of the month, I believe, following the month of coverage, so there is that much. It's not a grace period, but it is a delay in making payment, and that provision is in there.

Q. Yes, but that is the due date. There is a specified due date but no statement about what would happen if it wasn't paid on that due date.

A. No, I don't believe so.

[141] Q. Now, on a typical A and H policy, a typical life policy, there is a grace period, isn't there?

A. There is a great difference between the policy—the contract between the insurance company and the insured as compared to a contract between two insurers.

Q. The example we discussed in our first example, if the monthly premium wasn't paid by the insurer to the reinsurer, the policy would cancel, it would automatically terminate, wouldn't it?

A. No, I think those treaties are very much like these in that regard.

Q. First of all, the premium payment on those treaties you said was payable at the outset of the coverage for the month, by the reinsurer as of January 1st under the example which you gave. I would pay one month's premium and in February I would pay another month, then I would have a grace period, and if I failed to pay, the policy would—the reinsurance treaty would lapse and I would have the risk myself.

A. Well, again——

Q. Is that what you said?

A. No, I did not say that. I said that the reinsurance agreements, the type that I am talking about, where there is a requirement for a monthly remittance of premiums to the [142] reinsurer from the ceding company, is quite similar to this. I'm sure they've got cancellation provisions, but they don't specifically say it cancels if you don't pay the premium. It does say that the reinsuring company is on the risk as long as the ceding company—to the extent that the policy is reinsured, of course—and if the ceding company gets off the risk, the reinsurer is off the risk. I really can't recall off-hand the conditions under which a reinsurer cancels the contract for non-payment of premiums. I don't believe I have ever seen that provision in the insurance contract, as a matter of fact.

Q. So you don't know—what you are telling me is you don't know what the provisions are, you don't know when the premium is due under a reinsurance?

A. I know when the premium is due, I am not saying that. I am saying I don't think these reinsurance contracts or any reinsurance contracts generally, that I have seen, have any

specific cancellation for non-payment of premium. They have other provisions, which I believe will in effect protect the companies, but——

Q. Such as what?

Mr. SINGER. Excuse me, Your Honor. We have been allowing this line of questioning to go on even though the treaties are in evidence, as I am sure Mr. Schwarz would point [143] out and has pointed out in our past submissions, that they are the best evidence of their terms. But I think perhaps, so that this interchange will make some sense, there is a paragraph in the Pilot and National Fidelity treaties which we think is relevant and perhaps should be read. Maybe Mr. Eddy, having been reminded of this paragraph, might have a better basis of answering Mr. Schwarz's questions.

Mr. SCHWARZ. Certainly.

Mr. SINGER. This is paragraph 5 of——

Mr. SCHWARZ. One moment. I will get my copy.

Mr. SINGER. Paragraph 5 of the Pilot Life Treaty, and also paragraph 5 of the National Fidelity Treaty. "If this agreement is terminated as to new insurance, Pilot Life shall nevertheless be liable to American Universal for payment of monthly reinsurance premiums until all premiums on policies reinsured with American Universal prior to the termination have been earned."

Mr. SCHWARZ. Excuse me. Would you point that out to me again.

Mr. SINGER. I'm sorry, Roger.

Mr. SCHWARZ. Paragraph 5 here?

Mr. SINGER. Yes, this is it, under Article 3.

Mr. SCHWARZ. Would you repeat it again.

Mr. SINGER. Do you want me to start from the [144] beginning?

Mr. SCHWARZ. Please.

Mr. SINGER. Okay. I am sorry, I should have made that clear. This is Article, Roman, III, paragraph 5. "If this agreement is terminated as to new insurance, Pilot Life shall nevertheless be liable to American Universal for payment of monthly reinsurance premiums until all premiums on policies reinsured with American Universal prior to the termination have been earned, and American Universal shall

nevertheless be liable to Pilot Life for payment of all claims arising out of policies reinsured with American Universal prior to the termination. After all reinsurance premiums have been paid, American Universal shall pay Pilot Life the amount of any claims on such reinsured policies, which claims were paid by Pilot Life and not deducted from reinsurance premiums, upon receipt of a statement of the amount of any such claims."

A. I understood your question to be, and I interpreted it to be the type of provision that is in the policies directly with the insured, not in the case of a credit accident, because he pays a single premium, not in case of these contracts, because they are single premiums and there are no future premiums from the policy holders, but I was trying to interpret your question in light of the non-payment of premium provision that you find in the normal life insurance policy, [145] which specifically says if you don't pay the premium, the policy lapses, but that type of provision is not in these contracts. That's the way I was trying to answer your question.

By Mr. SCHWARZ:

Q. Is the provision of the sort that we described here, the sort that Mr. Singer just read—in other credit reinsurance treaties, credit accident and health, credit life reinsurance treaties?

A. Those, but they are runoff provisions, so-called runoff provisions, and those on a monthly premium basis, sure.

Q. They require the reinsured to provide coverage for the remainder of the term and they also require the insurer, the ceding company, to remit full premiums with regard to policies in force when they are due, even if coverage is canceled with regard to new insurance?

A. Correct.

Q. Now, what other kinds of insurance, other than credit reinsurance, other kinds of reinsurance, other than credit reinsurance, have you seen that particular provision in?

A. Well, that provision would be in all contracts of reinsurance. I mean you can find all types of arrangements. I'm not presuming that in every case that you have this, but generally speaking, in reinsurance contracts, either company can cancel the contracts, usually within sixty or ninety days

[146] notice, with respect to new business, or sales not yet made, but not with respect to business in force, and in any type of policy, reinsurance contract, where there was coverage beyond the cancellation date, with respect to policies then in force, from which the reinsurer had not received all the premiums, it was yet due, the agreement would provide for continuation of premium payments by the ceding company to the reinsurer and a provision, the same provision, I suppose, requiring the reinsurer to continue to carry—to provide the protection until the expiration of those policies.

Q. You have referred to policies other than credit reinsurance. Can you give me such policies that you have seen?

A. Practically every insurance agreement I have ever seen, I don't know how many of those are, but there are a whole bunch of them.

Q. What are the cancellation provisions you referred to before? They didn't relate—you didn't say they related to the coverage that still was yet to come, but to future——

A. Policies that would be issued beyond, after the date of cancellation.

Q. You also suggested that there were some provisions analogous to the provision of permitting the policy to lapse in the event that the insurer did not remit the next month's [147] reinsurance premium.

A. No, I didn't say that. In fact, I said that that wasn't in there. The provision in the policy—the contract between the ceding company and the insured has such a provision. In fact, it's a premium payment. It's a cancellation in the event of non-premium payment and it's a standard provision as part of the requirements of all states to be in all individual insurance policies that are paid on the basis other than single premium.

Q. You mean an insurer is required, if he has a monthly reinsurance treaty, a typical monthly treaty requires him not to insure monthly but to insure for the full term the insurance.

A. No, I was talking about the contract between the insuring company and the policy holder. There is a provision, a standard provision requiring the insurance company, incorporated in the policy, a provision which in effect says the policy cancels on non-payment of premium. Now, that

provision is not in these reinsurance contracts or in any reinsurance contracts, but there is a provision somewhat similar to the one that was just read to me in all contracts that I have ever seen on reinsurance unless it does not provide for the runoff. If it doesn't provide for the runoff, then the cancellation could be complete with respect to all [148] policies at the moment of cancellation.

Q. Doesn't the typical reinsurance treaty give the party the right to cancel on thirty or sixty or ninety days notice?

A. I think it gives both partie the right to cancel.

Q. How much notice is generally required?

A. It varies—sixty to ninety days. I think not less than sixty, not generally more than ninety.

Q. Are you telling me the typical reinsurance treaty requires—permits either party to cancel in sixty to ninety days notice?

A. Generally speaking.

Q. Or some such. Does this treaty have any term of that sort in it?

A. This has a termination provision in it, yes.

Q. But you said that the entire—can the entire coverage, even coverage in force, be canceled?

A. Well, these three treaties are different.

Q. I am talking about these. I am comparing these two, the Pilot and National Fidelity, to other reinsurance treaties.

A. But those two treaties provide for termination, but the coverage is only with respect to business issued after the moment of cancellation.

Q. Now, does the typical——

[149] A. That's the same with these other treaties.

Q. My understanding was that the typical reinsurance treaty provided that the insured—I'm sorry, provided that the ceding company could cancel future reinsurance on all business which it was then insuring by giving the reinsurer notice. It would not have to pay future reinsurance premiums. In other words, a ceding company wants to reinsure a certain amount of its business, knows that when it gets to a certain point, it will be able to handle that business on its own or it may want to reinsure with someone else, and the typical reinsurance treaty provides for a monthly reinsurance premium for all business in force.

So if there is a million dollars in force, the premium would be a percentage of that or a rate per thousand, and provide for monthly reinsurance premiums. That payment would be made at the beginning of each month for coverage for the month that was beginning, and the insurer, the ceding company, would have the right to cancel the entire treaty and either insure with someone else or take the business itself.

A. Only with respect to policies that had not yet been sold, not with respect to policies then in force. But there are exceptions and those are the cases where you do not have a runoff provision. If you don't have a runoff provision, and there are treaties like this, where companies are willing to [150] cancel either way, sometimes unilaterally, sometimes bilaterally on a given notice, or generally sixty to ninety days, sometimes less than that, but——

Q. Can you give me—can you state a treaty that you have seen, other than a credit accident and health reinsurance treaty which permits—which requires that the insurer continue to reinsure with respect to coverage in force on this monthly basis?

A. Well, yes, you can examine the reinsurance treaties of Lincoln National with any number of companies. I will mention one that specifically I knew, several—one is with the Pilot, one is with Jefferson, one is with the State Capital.

Q. What kind of insurance is this?

A. Beg pardon?

Q. What kind of insurance coverage is this?

A. This is what we have been referring to as ceded—do you call it ceded reinsurance?

Q. What kind of insurance policies are being reinsured?

A. Different types. In some cases accident and sickness, sometimes life, mostly with the Lincoln treaties—mostly they are in the life insurance business, although they offer reinsurance. The American United—very heavy on accident and health reinsurance. You can look at treaties on [151] those, they are quite similar.

Q. And they do not permit the insurer to cancel the reinsurance——

A. No, there is an exception in that, which I have mentioned, that there is generally today, particularly in new treaties, and I suppose most treaties have been amended, in particular where

the client was big enough to insist on it, due to competitive influences. There is the provision for recapture, or not generally, immediately, but there is some period of time that the reinsurance company has to protect it, usually three to five years. In earlier days, fifteen, twenty years ago, you didn't have such provisions in the treaties. Once reinsurance commmenced, it was in force until the end of the policy, regardless which party wanted to cancel.

Q. In the kinds of policies you are referring to, it would be where the premium paid by the ceding company to the reinsurer would, say, be on a monthly basis, whereas the premium it was receiving would be on an annual basis, or some longer basis?

A. You had all combinations. You would have the case where the policy holder was paying monthly and the ceding company is paying to the reinsurer annually. They had the cases where the policy holder paid single premiums and the ceding company paid to the reinsurer annually. You also have [152] cases with any sort of premium between the policy holder and ceding company, monthly payments, annual payments. I don't know of any cases where the ceding company pays a single premium where the policy holder pays annually. I don't know. But practically any kind of policy is in existence in both directions.

Q. I'd like to continue with the treaties in force and dicuss a couple terms.

Mr. SCHWARZ. Can we take a five-minute recess, Your Honor?

The COMMISSIONER. Very well.

[After a recess, the hearing proceeded.]

By Mr. SCHWARZ:

Q. Let's turn to the Pilot and National Fidelity treaties. Do you have a copy of one of them there?

A. I have the National Fidelity.

Q. The A and H treaty?

A. Yes.

Q. Is it your understanding that under these—I'd like to review some of the terms of the treaty, and I realize, as Counsel said, they speak for themselves, but I'd like to get the workings of the treaty in perspective.

Each month the earned premium portion of the premiums received by the insurer would be calculated, and is [153] it cor-

rect that they were done by taking the premiums received during the month and adding the unearned premium reserve at the end of the previous month, subtracting the unearned premium reserve at the end of the month, and that would be the basis——

Mr. SINGER. Mr. Eddy was not an actuary of our company during those years, and I don't think he can tell you——

Mr. SCHWARZ. All I am trying to is identify the term.

Mr. SINGER. He can testify whether that is the term of the treaty, sure.

Mr. SCHWARZ. That's what I am asking.

A. Yes.

By Mr. SCHWARZ:

Q. I want to make sure I understand it. Now, there was a 2% retainage, and I understand 2% would be taken off that figure.

A. That's my understanding.

Q. All right. Now, under Article III, item 3, it says—paragraph 3—it says, "From the reinsurance premium due American Universal, it shall be deducted and withheld by Pilot Life," and then (a), following Expenses, which were assumed by American Universal: "One, premium taxes; two, cost of the forms; three, special claim expense; and four, commissions, paid or retained by agents for writing the insurance."

[154] Now, is it your understanding that, or do you know, whether full commission or only—full commission paid by the insurer in this business or only part of it would be subtracted from this monthly premium that is to be remitted?

A. Well, according to these terms, it was commissions paid. That would be—to me that means whatever the total commission paid was during the month.

Q. So in the early——

A. Cash payments.

Q. Is it correct then in the early months of such a treaty, the commission paid on these policies by the ceding company would be much more than monthly earned portion of these premiums?

A. Well, that depends on the basis of commission payment. I don't know how to answer that without having examined their accounting.

Q. All right. If the commission payment were between 20 and 30%, if it were between 20 and 30% of it——

A. Of what?

Q. Of the premium—that the ceding company received from the policy holder,——

A. All right, this is 20 or 30% of the cash premiums received from the policy holders?

Q. That's right.

[155] A. All right.

Q. And these policies averaged—let's assume they averaged two years in length, and I believe we stipulated what the average was.

Mr. SINGER. No, we didn't, Roger.

Mr. SCHWARZ. All right. Then let's just assume that for the purposes of the hypothetical question—would not the commission payable in the early months of this treaty be far in excess of the earned premium portion that was to be remitted to the reinsurer, even before claims were deducted?

A. You mean like the first month this treaty was in effect, as an example of early months?

Q. Yes, let's take an example.

A. The treaty went into effect July 1, 1957, and you mean for the month of July, 1957, would the commissions paid be greater than the earned premium? In all probability, yes. I am assuming that they are paying 20% cash on the gross premiums. That's what I suspect they did.

Q. Now, is this a typical reinsurance treaty provision whereby in the early months of a treaty, the reinsurer would have to make substantial payments to the insurer, even before any claims during that period were deducted?

A. The reinsurer paid substantial payment to whom?

Q. To the insurer.

[156] A. The reinsurer doesn't make any payments to the insured.

Q. It says, under Article IV, "For the time established remaining, any premium remittance, the total of the deductions listed in the preceding section of this article exceeded 98% of the earned premium for the month, American Universal shall pay to Pilot Life the amount of such excess upon receipt of a statement."

A. But that's not the insured. That's to the ceding company.

Q. Did I say to the insured?

A. Yes.

Q. I'm sorry, I meant to the ceding company.

A. All right. Well, I don't think that's uncommon, no, but whether—whether I could say that's the usual, I don't know—it's not uncommon.

Q. I am sorry, I didn't understand your answer.

A. I think this is not uncommon, no.

Q. Where is it common?

A. Well, it's common at Pilot Life Insurance Company and several dozen companies dealing in this matter, and I think also true with American Bankers and American National, it's true of Lincoln National, North American. How many companies do you need to name?

[157] Q. Is this on credit insurance?

A. Amongst other things, credit insurance.

Q. What other kind of insurance?

A. Regular insurance where there might be a co-insurance arrangement.

Q. What's a co-insurance arrangement?

A. Well, it's another type of insurance we haven't been talking about, except it's somewhat similar to the surplus relief insurance you were talking about earlier, but it's not uncommon at all to have a payment from the reinsurer to the ceding company at the outset of the program.

Q. I see. And it is typical in credit, in credit reinsurance and typical in other situations where co-insurance arrangements, similar to surplus aid treaties of the type we talked about, are in force.

Q. Is that what you said?

A. Well, I think you would find this kind of thing might be common in all similar contracts, and this might encompass almost every insurance company involving credit insurance principally during the period you are talking about. There were just a few major companies that were reinsurers in this field because they were—Old Republic being one of the leaders because they were themselves first in the credit business.

[158] One thing that might be of interest to you, the credit insurance industry is very new, as far as having—being material to the insurance industry. At the end of World War Two, there was only about a billion dollars worth of this insurance in force. The boom in the credit insurance business has been since the war, and it's been parallel to the increase in consumer credit. Today the credit insurance in force is maybe something

like seventy-five billion dollars. That's a pretty substantial increase during that period of time, from practically none to that much.

Now, Old Republic was a leader in this, Pilot was a leader in this. Several other companies that were influenced by Old Republic personnel, who gravitated to various insurance companies during this period, were beginners in it, and they offered extensions of this type of contract to essentially all insurance companies that were in the credit insurance field.

Q. Isn't this a form of surplus aid contract?

A. I don't believe that was the intention of it. I don't think that——

Q. It may not have been the intention. I am not concerned about intention, I am asking whether it is.

A. No, I think not. I think this is the reverse. Barring the first few months, there may be a payment from [159] the reinsurer to the ceding company, but this would be hardly to be expected. It would be sort of ridiculous for the Pilot Life to be expecting to get surplus relief from ITT Hamilton as it was in those days.

Q. Well, it was getting to hold the premium remitted on a monthly earned basis.

A. That's true, but that was part of their business arrangement.

Q. Well now, I want to understand to what extent the practice we are talking about was used before credit reinsurance of the type we are talking about came into being, and to be specific, talking about arrangements whereby reinsurance is paid on, quote, a monthly earned basis. But where a possibility existed under the treaty in the early months, at least, the reinsurer would remit the full commission, would be required to pay the full commission to the ceding company, and it would do so to the extent of the monthly commission. The monthly amount that it was receiving was not sufficient to cover that total commission.

Q. Now, in the physical kinds of policies you referred to before, where there was reinsurance on a monthly term basis, was this kind of term in there?

A. Well, if it was the risk premium reinsurance, no.

Q. If what?

[160] A. If it was the risk premium type reinsurance, no, because for one thing——

Q. What is a risk premium type?

A. Well, that's the most standard, most usual type reinsurance in the life insurance industry. It's where a company, A, the issuing company, or the ceding company, decides that it can't safely take more than $10,000 risk on any one individual. It sells a $15,000 policy, so it gets a reinsurer to accept the death risk, only with respect to the $5000.

You don't find this commission arrangement there because the only amount of money transmitted from this ceding company to the reinsurer is the net premium for the amount at risk, and it's just the risk premium, therefore called the risk premium reinsurance. That's really a European term for it. We call it yearly renewable term in this country, or YRT, but it was very common. As a matter of fact, it's a fundamental part of all co-insurance contracts for the reinsurer to make some sort of payments to the ceding company.

That's been in existence as long as co-insurance has been in existence, and I don't know precisely the origin of the co-insurance treaties, but I would say they date back to the 30's or 20's in this country.

Q. Well now, we have a new term here—co-insurance.

A. It all falls in the general category of reinsurance. [161] The specific name applies where the gross premium is transferred to the reinsurer rather than this net risk premium, and in that case actually the—it's very much like surplus relief. In fact, some people may consider co-insurance—may first call co-insurance surplus relief rather than co-insurance, but it's where the reinsuring company substitutes for the position of the ceding company in this first year surplus drain.

In other words, it in effect reimburses the ceding company for its expenses of underwriting and its commissions and takes only the premium which creates in the usual situation a net payment for the reinsuring company to the ceding company, and in this type of contract, since the credit insurance industry is that new, almost all of these are twenty-five years—less than twenty-five years old, you will find that almost every A and H contract, where there is credit reinsurance involved, is of this nature.

Q. So you are confining these co-insurance types of arrangements to credit insurance?

A. No, no, not at all. I was drawing a parallel between the requirement under this contract, making an initial payment from the reinsurer to the ceding company, with that same requirement under a co-insurance agreement, which have been in use considerably longer in this particular type of [162] contract.

Q. Under accident and health coverage, is the co-insurance arrangement a typical kind of reinsurance arrangement?

A. Yes, and as I say, I think this is a typical arrangement here, and if we are talking about credit, quite generally the arrangement of this same nature, which I consider co-insurance—co-insurance because the gross premium is transmitted instead of net——

Q. It's possible under some of these treaties for a negative reinsurance premium to be paid, isn't it? By that I mean a premium of more than 100% of the premium which the insurer receives—isn't that correct?

A. Well, that could come about, I believe, under these treaties in the event that the monthly earned premium was less than the claims for that month. If I might borrow the expression of the NATC subcommittee, remote but possible.

Q. I am referring to the situations where the capitalization of the reinsurance premium for deductions for expenses and claims would be more than a hundred per cent of the premium received by the ceding company.

A. Well, certainly, if they begin to have a runoff of business, that could easily be true because—or if they even come to a level production of new business, this would—[163] they would tend to be one and the same, but if there was a decline in the business of the ceding company, then this is going to be true because your block of new business continues to throw off this monthly increment and that's offset for the ceding company—it's offset, as far as their cash flow is concerned, by new premiums from new insureds.

Q. I'd like to ask a question or two about the deficiency reserves. In a situation you discussed involving deficiency reserve on direct examination, you said that at the end of—take a whole life policy, providing for annual premiums. At the end of the year the normal life insurance reserve on that policy calculated by use of tables would be upset, is that correct,

and then if it appeared that the present value of future benefits under the policies—perhaps you better——

A. Yes, I think I better, because you are going off the wrong way. If present value of future statutory premiums were more than the present value of future gross premiums, there would be a requirement for the deficiency reserve in addition to the regular reserve.

Q. Okay. And then that deficiency reserve would represent that excess for the remaining—over the remaining life of the policy, right?

A. If I can make the illustration maybe similar, this [164] was not a very uncommon thing back in the 30's, when deficiency reserves became a requirement. The valuation—the statutory term is synonymous—might have been for an ordinary life insurance policy issued at age thirty-five, say nineteen dollars a thousand. It was not uncommon for a life insurance company to be charging eighteen dollars.

Now, the deficit is simply the dollar for one year. Well, a life annuity factor on a statutory basis for policies of this nature was about twenty dollars, or twenty per dollar. So our deficiency reserve at the moment of sale would have been twenty times a dollar, or twenty dollars additional reserve requirement.

Now, the second year the policy is in force, the man is one year older. He is that much closer to death or that much closer to the end of the table. So the annuity value has decreased maybe to nineteen dollars and a half. So at the end of the second year the deficiency is a dollar times nineteen-forty-five or nineteen dollars and a half, and thus it progresses until the end of the premium paying period.

Q. Now, the reason why it decreases is the difference in the annuity value, that fifty cents that you referred to, is incorporated within the life insurance reserve addition for that period, isn't it?

[165] A. No, that's not the reason it decreases. The reason it decreases is because the present value of the difference is decreasing, and it's the present value of the difference between the premiums that you expect, statutorily, versus the present value of the premiums that you expect gross, that creates the deficiency and the amount of deficiency.

Now, at the end of the premium paying period, there is no more present value of either. Therefore, the difference has to be zero.

Q. Life insurance reserve at any period is the amount of premiums that you have already received which go to provide for coverage—not the amount of premiums, the amount of preminum necessary to segregate from the premiums you have already received or should have received under the policy in order to pay for future benefits that will not be covered by future premiums.

A. No, that's the retrospective definition, plus interest accumulated on what you held in the past.

Q. Okay. So that figure is calculated from a table, is that correct?

A. Right.

Q. What table is being used now to calculate that?

A. Well, most companies use ordinary policies, the 1958 standard ordinary table, with variance rates of interest.

[166] Q. Now, that table would create a life insurance reserve requirement as of that year on the policy without regard to the actual premium that was received. It could have been very high or very low.

A. Precisely. It's a statutory requirement. It has nothing to do with the premium being received. The only way that it is related to the premium being received, if I might make this point, is that the reserve, either life reserve, tabular reserve, if you want to call it that, or unearned premium reserve, they relate to the number of premiums or the proportion of the premiums received, not to the amount of premiums received, but the proportion of the premiums that's been received, and the proportion is related to the period of coverage for which the premium is paid. But the reserves themselves are statutory and they are artificial, and they are based on these statutory mortality tables.

Q. The life insurance reserve at the end of any one year would necessarily include a portion taken from surplus in the event that the premiums received were not sufficient to fund that reserve, although I realize we are talking about sinking funds. But if the premium were insufficient and the life insurance reserve would necessarily be composed not only of part of the premium but a part of surplus, ——

A. Well, are you referring to the deficiency reserve?

[167] Q. No, the life——

A. You are talking about a portion of the life reserve?

Q. Yes.

A. Well, to the extent that the life insurance reserve is redundant, based on mortality factors which are conservative, invariably the statutory reserve is—in effect, a portion of the statutory reserve must be realistically considered a portion of the surplus. It's just an earmarked or frozen surplus.

Q. Well, you are saying it is a portion of surplus because the company should have earned more that year, but they have to put an inordinate amount aside to compensate for the reserve requirement.

A. I hope I don't live to regret answering these questions in some other controversy, but I think that's true, and to make—to further add to your point, the AICPA, the American Institute of Certified Public Accountants, have issued their audit guide for life insurance companies and they have done precisely—they have precisely separated this portion of the reserve which might really be considered surplus because of the redundancy in the assumptions, and the portion of the reserve which realistically represents the liability, and they refer to the one that represents the liability, the true liability, is a natural reserve, and the [168] statutory reserve is an artificial conservatism imposed upon us by the statutes and must realistically be thought of as part of our surplus account.

Q. The total of those two is what is currently considered the life insurance reserve and from which these companies get deductions on their tax returns?

A. The total of those two are the statutory reserves, which are the basis for tax deductions, yes.

Q. I see.

Mr. SCHWARZ. I have no further questions.

The COMMISSIONER. Mr. Singer.

REDIRECT EXAMINATION

By Mr. SINGER:

Q. Mr. Eddy, let's continue on with this point for a moment. What would be the natural reserve in the AICPA view as far as the statutory premium reserves is concerned?

A. Well, conceptually it would be something similar. They are going to insist on not the gross unearned premium as a representation of your liabilities but something realistically appraising the true liability, and for reporting purposes you are going to be forced to show the difference, the loading, or the difference, rather, between the gross unearned and such natural reserves as earnings, or accumulatively as surplus.

[169] Q. Would the natural reserve—do you think the natural reserve would be approximately the net premium, which you referred to as the morbidity element?

A. They insist in being realistic with respect to everything. It would include not the net premium that we think of statutorily, but a real net premium related to the risk.

For instance, in the life insurance, we might put forty-five cents out of a dollar at issue date or decreasing term as a pretty close approximation to the average statutory reserve requirement, but we know in this business that claim ratios seldom get above 30%. So thirty cents might be then the natural reserve, but then we must also take into account probability of termination and, therefore, the need for refund of the difference. So we would have to establish those probabilities, and what that would amount to, it may come up to a fifteen cent requirement and then we are back to the forty-five cents, but we would determine it on a different basis.

Q. Are you talking just about life insurance reserve?

A. I just gave that as an illustration because it was easier.

Q. What about the unearned premium? Can you give a——

A. I meant that on the unearned premium on the net [170] basis. The same thing applies on the gross earnings—an unearned net. The gross unearned net would be nothing more than the statutory measure, for reporting purposes, and accounting people would consider something much less if you need the true reserve.

Q. But from an actuarial standpoint again, as a measure of the insurance risk, the unearned premium reserve, the gross unearned premium reserve, in your opinion, is excessive?

A. I believe—yes, that is certainly in my case—I believe that is shared by most actuaries.

Q. And the amount of the—the excess in your opinion is the loading?

A. That is correct. We refer to it as loading. It's really—represents monies for expenses and profits and, of course, most expenses on credit insurance have already been incurred at the outset.

Q. And getting back to the life insurance reserve, the life insurance reserve does not have any comparable loading type feature built into it as the unearned premiums does?

A. That's right, except in redundancy in the statutory factors, but the statutory reserve really only measures the risk insured against the statutory table.

Q. I take it that if the unearned premium was based on an older morbidity table than that, there would be a redundancy [171] factor even in the net premium of the unearned premium?

A. That's right.

Q. You testified during cross-examination that under a practice which arose subsequently to the years in suit here, if an insurance company ceded insurance, single premium, received a dollar from the policy holder, and then ceded fifty-five cents as a single premium for the entire portion of the policy reinsured, the type of policy term, the reinsurer would then set up on its books an unearned premium reserve under this new practice of a dollar. Is that a fair representation?

A. Yes. I don't think that is universal at this point. I don't think it is really an absolute requirement of all states at this point, but the companies who vary in their practice have to reflect that variance in the statements they produce.

Q. Well, suppose here—it would be hypothetical, but let's be realistic in the sense that we are looking at the treaties between ITT Hamilton and Old Republic, Pilot, and National Fidelity. Assume those provisions apply, and the hypothetical part of this question would be, assume that Old Republic, say, only paid over the term of the premium, only paid 55%. Would your conclusion, that you stated earlier, that ITT Hamilton is not required to set up an unearned [172] premium reserve, be different if these monthly earned premiums which were received only totaled fifty-five cents at the end of the policy?

A. I'm not sure I understand the question, but if you are saying that the amount of the premium that Old Republic remits to ITT Hamilton under these agreements on a monthly basis alters the reserve requirement, I say no. The reserve re-

quirement under this treaty would be zero at the end of each month regardless of how much premium in dollars and cents is remitted from Old Republic to Hamilton, or to ITT Hamilton, with respect to each month's coverage, because it measures—this is after the fact, this is on an earned basis.

Q. And would your conclusion be any different if—let's assume that under the Old Republic or one of the three treaties, or all of them, Old Republic was legally bound in some way to pay premiums on a monthly basis, and could not, as in perhaps a life insurance contract, could not simply stop paying premiums and not receive further insurance, does this have any bearing at all on whether ITT Hamilton is required to set up an unearned premium reserve?

A. No, it does not. In my opinion the unearned premium measures the proportionate part of an unexpired period of coverage, and this treaty, all these treaties, the ITT Hamilton didn't receive any premium before the expiration date of the [173] coverage.

Q. All right. Mr. Eddy, I am going to repeat myself. I want to make sure that after having heard the questions put to you by Mr. Schwarz and having considered all the factors that he brought up, whether the opinion you expressed earlier today, that ITT Hamilton is not, either from an actuarial standpoint or from a state regulatory standpoint, was not required or indeed permitted to set up unearned premium reserves under these treaties, whether you still hold that opinion.

A. I certainly still hold that opinion. ITT Hamilton had no unearned premium reserve requirements, either from an actuarial point of view or from a regulatory point of view, in my experience.

Mr. SINGER. All right, that's all

The COMMISSIONER. Anything further?

Mr. SCHWARZ. I just have about two questions.

The COMMISSIONER. All right.

RECROSS-EXAMINATION

By Mr. SCHWARZ:

Q. Can you think of any situation involving insurance, and not reinsurance, where, except for the examples you gave me

before involving either delay or late payment of a premium due at the outset of coverage or delay in paying because of a grace period specified in the policy, where a company will [174] accept a liability when it has not received the premium for that liability, unconditional liability at the outset of the coverage, or where it doesn't have a right to receive it at the outset of the coverage on the policy?

A. No, I don't believe so. The only thing that would remotely be similar to that would be the case where you have casualty type coverages, where the premium is—the final premium is not established until the expiration of the contract. This is generally with corporations, large types of coverages, fire and casualty type coverages, but even then I don't think that there is any—I am certain the insurers always have a right to the premium from the outset and they always collect some sort of advance against the premiums, usually pretty well calculated to be nearly what's going to be required.

Q. I have one other question. I would like to compare the reserve requirements under a group—under a term life insurance policy, with an accident and health policy of relatively short term. Let's take an example involving a four year term insurance policy, which is renewable yearly at a specified annual premium. Compare that on the one hand with an accident and health policy, four year accident and health policy, also renewable by paying the stated premium every year. What kind of a reserve must the insurance company [175] establish on that term insurance policy at the end of the first year?

A. This is an annual premium?

Q. Yes.

A. And when you said at the end of the first year, you mean at the expiration of exactly twelve months from the beginning of the policy?

Q. All right, fine.

A. The reserve requirement would be zero.

Q. Now, let's say the policy is taken out July 1st, and 12–31 is the valuation day.

A. Then it would be fifty cents on the dollar.

Q. On which policy?

A. On the life—the term. Not on the gross basis, however, but on a net risk premium basis.

Q. That would be the life insurance reserve?

A. Yes. So we might say if—it depends on the company's pricing structure, but let's suppose that the net risk premium is fifty cents and the commission and expenses and profits fifty cents. Then issuing it on July 1, a 12–31 valuation would have half of the period unexpired, and on a net premium basis it would be one-half of fifty cents remaining, or twenty-five cents reserve account.

Q. I see. And under the A and H example, it would be [176] a gross reserve?

A. That's correct, it would be fifty cents in the same situation.

Q. I see. Now, if you had a long term A and H policy, comparable to a whole life insurance policy at the end of the year that we are referring to, how would you set up the reserve comparably?

A. You had a long term?

Q. You had a whole life policy and you had a policy which is considered non-cancelable under the industry's definition of the term, which you stated earlier, which was stated to you in direct examination, what would be the comparable reserve requirements under both policies?

A. Well, under the life insurance policy, because—we are speaking of level premium life insurance—the policy holder pays the same premium every year—you would have a portion of the first premium would have to be reserve and set aside to earn interest, so at the end of six months you have whatever reserve, and there are some technicalities on this, but I think in concept this is sufficient. In the case of an A and H policy, ——

Q. Wait a second. In the case of the life, it is a net reserve, is it?

A. It's based on the valuation, on the statutory [177] reserve requirement, yes.

Q. Which is net?

A. Right. In the case of the accident and health policy, you could have two situations. We have to further define long term, or we have to——

Q. Let's say the policy—I said the policy is noncancelable within the industry definition of the term.

A. Within the industry definition of non-cancelable, at the end of the first six months of the policy, which is the illustration here, you would have one-half of the first premium on a gross basis, and comparably you would have a reserve, a por-

tion of the premium of the first year set aside to be accumulated at interest.

Q. Now, is this example you give a typical example?

A. With the reservation that because of a peculiar method of calculating the tabular reserves, ——

Q. Well, regardless of that typical example.

A. I've got to give you the reservation because that's not typical, except in concept. In concept that's exactly what happens. But specifically the life policy, the reservation of the position of the life premium wouldn't commence until the beginning of the second year. The A and H doesn't start until the second or third year, but conceptually you would have no excess in the first year, the first two years, [178] as an illustration.

Q. Yes, but your statements reflect what your original answer to my question was, not what is conceptual. The annual statement filed with the commissioners and the tax return prepared on that same basis would show what you said it would show.

A. Yes, in concept it would show in one case, a life reserve which is net, and it was a small portion of the first premium reserve, accumulated, and in the A and H it would show one-half of the gross premium paid that year plus a small portion, generally zero at the first year, with a small portion reserved in the A and H policy calculated in a similar manner to the life reserve.

Q. What are the names of the two you referred to in the A and H policy?

A. Well, the unearned premium, the unearned gross premium, is half of the gross premium, and I think the actuaries may vary in what they would call the other, but in the convention blank it is—Exhibit 9—they have a line which they refer to as additional reserve, guaranteed renewable, non-cancelable policy. That's not a very descriptive name, but that's what they call it.

Mr. SCHWARZ. I have no further questions.

By the COMMISSIONER:

[179] Q. Mr. Eddy, no pun intended—I suppose this might be called a morbid question—but would you tell me what morbidity means in the insurance industry as applied to these types of policies you have been speaking of?

A. All right. To me, and I think this represents other actuarial viewpoints, morbidity refers to the probability of becoming disabled or sick, and mortality refers to the probability of dying. Those are the differences in the two.

Q. And they do have statistical information with respect to what the probability of becoming ill is, being in an accident?

A. Yes, sir, quite exhaustive statistics.

Q. That's interesting. Thank you very much, Mr. Eddy.

A. Thank you, sir.

Q. You may step down.

[Witness excused.]

The COMMISSIONER. Anything further, Mr. Singer?

Mr. SINGER. I think I will turn it over to Mr. Jones now.

The COMMISSIONER. All right.

Mr. JONES. Well, we are ready to close the record if the Government is. I don't know if they have any additional plans or not.

The COMMISSIONER. How about it, Mr. Schwarz?

[180] Mr. SCHWARZ. We wanted to stipulate as to the method by which the premium was remitted to the insurer, and I'm not sure——

Mr. JONES. A supplemental stipulation we discussed earlier this morning.

Mr. SCHWARZ. It will still be?

Mr. JONES. Yes. We have nothing further to introduce that has not been mentioned here today. The supplemental stipulation and the transcript, of course, is part of the record. I will restate it. We have no further witnesses to offer if the Government has no further witnesses to offer.

Mr. SCHWARZ. We have none.

The COMMISSIONER. All right. Then the proof is closed with the exception of the remaining opening for the purpose of the supplemental stipulation, and I believe also a stipulation with respect to Mr. Eddy's expertise. When the reporter has gotten this transcript done up for us and filed, I will file a formal notice of closing of proof, which will start your time running for requested findings.

Mr. JONES. Would it be appropriate to talk to the time limits?

The COMMISSIONER. Certainly.

Mr. JONES. This is a complicated case. We are anxious to get it done, and I can see us doing it within thirty days, but I

would be awfully annoyed if I am banging my head for thirty days to get it out, or Mr. Singer had thirty days and the Government took ninety or 120 days. We would accommodate ourselves to any period the Government thinks is reasonable for these briefs, but we hope it would end up at least roughly comparable in time, and if the Government proposes to file its brief thirty days after ours, that's fine. If he wanted an extension, I would prefer to know it now,—maybe forty-five days for each other, or maybe even sixty days, but I would be guided by the Government's suggestion.

Mr. SCHWARZ. Well, I don't want to direct your result by mine. How much time would you like?

Mr. JONES. I would like the same amount of time that you have.

The COMMISSIONER. I don't think we need this on the record, Mr. Reporter.

[Off-the-record discussion.]

The COMMISSIONER. All right, thank you very much, gentlemen.

[Whereupon, at 4:00 p.m. the hearing in the above-entitled matter was concluded.]

STIPULATION OF QUALIFICATIONS OF ARTHUR C. EDDY AS EXPERT WITNESS

(Number and title omitted)

By agreement of counsel for Plaintiff and Defendant, the following qualifications of Mr. Arthur C. Eddy are submitted in lieu of a voir dire examination:

1. Mr. Eddy attended the University or South Carolina and received a Bachelor of Science degree (in Mathematics) from that University in 1946. He spent approximately 14 years (from 1948 to 1962) with the Pilot Life Insurance Company of Greensboro, North Carolina. He joined the company as a clerk in its actuarial department and was its second Vice President and Associate Actuary when he left. He has been a consultant to the insurance industry since 1962, first with the firm of Bowles, Andrews and Towne and, since 1970, with the firm of Towne & Eddy, both of Atlanta, Georgia. Mr. Eddy is a Fellow of the Society of Actuaries.

2. Mr. Eddy's duties at Pilot Life included computation of insurance reserves and preparation of Annual Statements for submission to the insurance departments of 16 or 17 states in which Pilot was qualified to do business, including the State of Missouri. As a consultant, Mr. Eddy has advised numerous insurance companies on policies, reserves, and the regulatory requirements of the states. He is familiar with the standard valuation laws in force in all fifty states, and with the requirements and examination procedures of the National Association of Insurance Commissioners. He is also familiar with business practices in the insurance field generally and in the credit insurance industry in particular.

3. Mr. Eddy has testified as an expert witness on credit insurance matters in the case of *Alinco Life Insurance Co.* v. *United States*, in 1965, before The Honorable Lloyd Fletcher, Commissioner of the Court of Claims, and in the case of *Superior Life Insurance Company* v. *United States*, in 1970, in the United States District Court for the District of South Carolina, and other cases.

Respectfully submitted,

OWEN T. ARMSTRONG,
Attorney for Plaintiff.
FRED B. UGAST,
Acting Assistant Attorney General.
ROGER A. SCHWARZ,
Attorney for Defendant.

AMENDMENT TO STIPULATION OF FACTS

(Number and title omitted)

(Filed: December 30, 1971)

Plaintiff, ITT Hamilton Life Insurance Company, and Defendant, United States of America, jointly move to amend the stipulation of facts submitted by the parties on August 6, 1971 in the following respects:

1. Paragraph 27 of the stipulation of facts shall be amended by deleting the year "1962" from the penultimate sentence of the second paragraph of paragraph 27 (page 15 of the stipulation). As amended, paragraph 27 shall read as follows:

"27. Several methods can be used to arrive at a value for the unearned premium reserve where many policies are outstanding at the statement date. The most precise would be to determine the exact date of issuance of each outstanding policy so that the unexpired portion of each policy in force at the statement date can be ascertained. However, the cost and time involved in making such a computation is prohibitive to companies without sophisticated data processing equipment. Therefore, assumptions are commonly made as to the dates on which outstanding policies were issued.

The unearned premium reserves maintained by Old Republic, Pilot, and National Fidelity on credit accident and health insurance covering debtors of Aetna and its subsidiaries, as well as the unearned premium reserves maintained by Plaintiff under its reinsurance treaty with Insurance City, were computed monthly on the assumption that all policies issued during a particular month were issued at the end of the month. For example, if Old Republic received $100,000 in accident and health premiums during the month of December with respect to the issuance of credit life, accident and health policies to Aetna loan customers, its unearned premium reserves were computed on the assumption that all of such policies were issued on December 31, and that the $100,000 in premiums were likewise received on December 31. The Internal Revenue Service has recomputed such unearned premium reserves maintained by Old Republic, Pilot, National Fidelity and Plaintiff at December 31, 1963, 1964 and 1965, using an assumption that all policies issued during a given month were issued on the 15th day rather than the last day of such month. Plaintiff does not contest such adjustments."

2. The following new paragraphs numbered 59 and 60 shall be added to the stipulation:

"59. Under Plaintiff's reinsurance treaties with Pilot and National Fidelity, there would be deducted from the reinsurance premiums payable to plaintiff each month, the charge for the total commissions and pre-

mium taxes paid with respect to policies and certificates of insurance issued by those companies during the previous month. Commissions and premium taxes were based upon the full premium charged on such policies and certificates, whereas the monthly reinsurance premiums receivable by Plaintiff under the above treaties were based upon the portion of premiums defined in the treaties as earned in the previous month. Thus, the first few monthly reinsurance premiums receivable by Plaintiff with respect to a newly issued policy or certificate would normally be less (individually and in the aggregate) than the related amount of premium taxes and commissions deducted from Plaintiff's reinsurance premiums for the month in which the policy or certificate was issued. The aggregate amount of monthly reinsurance premiums receivable by Plaintiff with respect to all outstanding policies and certificates theretofore issued during the treaty period under the above reinsurance treaties exceeded amounts deducted for taxes and commissions within a few months after the inception of the treaty period."

"60. At the end of each month, Aetna prepared a check payable to the appropriate ceding company in the amount of the adjusted gross premiums collected on behalf of the ceding company during the month less commissions paid. The check would either be mailed to the ceding company (as was true in the case of Old Republic and Insurance City) or deposited in a bank account of the ceding company (as was true in the case of Pilot and National Fidelity)."

Respectfully submitted,

OWEN T. ARMSTRONG,
Attorney for Plaintiff.
SCOTT P. CRAMPTON,
Assistant Attorney General, Tax Division.

_____ _____,
Attorney for Defendant.

Supreme Court of the United States

No. 75–1285

UNITED STATES, PETITIONER

v.

PENN SECURITY LIFE INSURANCE COMPANY

Order allowing certiorari

(Filed May 24, 1976)

The petition herein for a writ of certiorari to the United States Court of Claims is granted. The case is consolidated with Nos. 75–1221 and 75–1285 and a total of one and one-half hours is allotted for oral argument.